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APPENDIX TO PETITIONER'S BRIEF

IN THE

United States Court of Appeals

FOR THE FOURTH CIRCUIT

No. 7391

SOUTH CAROLINA GENERATING COMPANY,
Petitioner,

VERSUS

FEDERAL POWER COMMISSION and
GEORGIA PUBLIC SERVICE COMMISSION,
Respondents.

No. 7393

SOUTH CAROLINA PUBLIC SERVICE COMMISSION,
Petitioner,

VERSUS

FEDERAL POWER COMMISSION and
GEORGIA PUBLIC SERVICE COMMISSION,
Respondents.

ON PETITIONS FOR REVIEW OF AN ORDER
OF THE FEDERAL POWER COMMISSION

FILED
MAR 29 1957
R. M. F. WILLIAMS, JR.
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Petitioners' Appendix
Part II

THE STATE COMMERCIAL PRINTING CO.

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Petitioners' Appendix

Part II

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STATEMENT

In its order setting the hearing in this investigation the Federal Power Commission ordered that the direct testimony of the South Carolina Generating Company be served in advance of the hearings. For that reason the direct testimony of each of the witnesses was given an exhibit number.

To the direct testimony of some of the witnesses, statements were attached as parts of the witnesses' evidence. It is our view that it is unnecessary to reproduce these statements as a part of this appendix. If, in the preparation of briefs, a different conclusion is reached as to any of the statements it is our intention to furnish such statements for the use of the Court and of counsel.

The contract in issue here (Exhibit A) between the South Carolina Generating Company and the Georgia Power Company is not printed but sufficient copies for the members of the Court will be filed.

Since the orderly preparation of briefs requires that this Appendix be printed prior to the filing of the record by the Federal Power Commission the pagination herein may vary from that in the certified record.

TESTIMONY SUBMITTED BY THE SOUTH CAROLINA GENERATING COMPANY

EXHIBIT 1

DIRECT TESTIMONY OF HARLLEE BRANCH, JR.

1. Q. Will you please state your name, address, and position with the Georgia Power Company?

   A. My name is Harllee Branch, Jr. I reside at 3106 Nancy's Creek Road, Atlanta, Georgia. I am President of Georgia Power Company.

2. Q. As the President of Georgia Power Company, did you have general supervision of negotiations in connection with the contract which was finally executed between your Company and the South Carolina Generating Company on November 9, 1951?

   A. Yes. The negotiations were actually handled by other representatives of our Company. However, as President of the Company I directed that the negotiations be undertaken and was kept generally informed of their progress. I signed the contract of November 9, 1951 for the Georgia Power Company.

3. Q. In the early part of 1951 did the Georgia Power Company have under consideration the building of generating capacity in the Augusta area?

A. Yes.

4. Q. At or about that time did the Georgia Power Company acquire a power site and have on order a 60/66,000 KW steam generating unit for installation near Augusta, Georgia?

A. Yes. Formal commitment for the purchase of a turbo-generator with optional capacity between 40,000 KW and 100,000 KW was made on September 25, 1950. Late in May 1951 it was decided to make this unit 60,000/66,000 KW. A power site near Augusta was selected and we began acquiring options in the Spring of 1951. Title to the tract was acquired during the Summer of 1951.

5. Q. In connection with the power needs of Georgia Power Company in the Augusta area, did you authorize your company to begin negotiations with South Carolina Electric and Gas Company for a source of power for the Augusta area?

A. Yes.

6. Q. In determining whether to enter into the proposed contract with South Carolina Generating Company, did the Georgia Power Company consider the possibility of obtaining an equal amount of electrical energy from other sources, including the construction of its own steam generating plant in the Augusta area?

A Yes.

7. Q. After considering all of the possibilities, what conclusion did the Georgia Power Company reach with reference to the desirability of entering into the contract for this electrical energy with South Carolina Generating Company?

A. The Georgia Power Company concluded that its best interests would be served by contracting with the South Carolina Generating Company for this supply of electrical energy. This decision was based upon the following considerations:

(a) The cost of power from a two-unit plant is cheaper than the cost of power from two single-unit plants built at approximately the same time and in the same locality;

(b) Plans for the South Carolina plant, only about two miles from our proposed site, were further advanced, and it was felt that the needed power supply for the Augusta area could be obtained more quickly and more cheaply from that source;

(c) Special financing, not available to our Company was possible for the South Carolina plant. The South Carolina company offered to share these benefits, together with other savings in construction and operating costs, with our Company.

(d) Our Company was, and had been for a number of years, involved in a large expansion program so that it was considered desirable to limit our capital outlays wherever possible without prejudicing our service or rates. This could be done by purchasing our power requirements for the Augusta area; and

(e) It was possible for our Company to obtain additional service protection by contracting for power from a two-unit plant with the right to utilize one-half of whatever capacity was available at the plant in the event of a unit failure.

GEORGIA
FULTON COUNTY

Personally appeared Harllee Branch, Jr., who being duly sworn says that the foregoing answers are true.

(Signed) HARLLEE BRANCH, JR.

Sworn to and subscribed before me
this 5th day of April, 1955.

(Signed) ROY HARWELL
Notary Public, Fulton County, Ga.

Notary Public, Fulton County, Georgia
My Commission Expires April 26, 1958.

CROSS-EXAMINATION OF MR. HARLLEE BRANCH

(77) Cross-Examination by MR. WAHRENBROCK:

* * *

(84) Q. Then at the time of the beginning of the negotiations between the two companies, the Electric and Gas had only a plan for a single unit station in mind?

(85) A. That's my assumption, and I am quite sure that is true because, as a matter of fact, my recollection is that it was my company that first broached the idea of building capacity for our use into that plant.

* * *

(95) I will say this to you, that I understood throughout the course of those negotiations that South Carolina Electric and Gas Company would not be willing to build capacity into a plant which it in effect was financing in addition to its own capital requirements for our benefit unless they had a right of recapture; and we were not willing for them to have that right of recapture unless we were given an adequate time within which to build substitute capacities if they exercised that right.

We fully understood that at such time as it might be either necessary to carry their loads, or because of the economic advantage of it, for them to recapture that capacity, yes, they would capture it.

* * *

(97) Both in government power contracts that we have had occasion to negotiate and in a vast number of contracts we are familiar with, the idea of a recapture at the instance of the party constructing or owning the plant is not unusual.

* * *

(98) Since 1945 my company—and it is not a big company—has been building new plant at the rate of $35 million to $50 million a year. That is a whale of a lot of new capital to try to digest into your system.

Any construction of this kind, which on an economical basis we can forego and still not have it detrimentally affect our ability to carry our loads and to officially serve our customers, is a big advantage to us.

That is what I meant, hoping to avoid. We wanted to carry our load efficiently, as we have always tried to do; but if somebody else would build the plant for me and do it on terms that would compare favorably with my cost, I was delighted to have them carry a part of my burden for me.

• • •

And I might say I think it is a direct advantage to my ratepayers to avoid as much of that capital expansion as I can because of the fact that we thereby less dilute our capital structure and have to acquire or obtain less new financing and the results of that ultimately, I believe, is a saving and a benefit to them as well as to the company.

• • •

(99) Q. A saving in what respect?

A. In this respect, and in this specific instance: We were able in this particular case to have a plant built at a money cost—and our 75,000 kilowatts—at a money cost appreciably more favorable than would have been possible under our capitalization ratios to build the same capacity.

To that extent it was not just a benefit to the company, but it was a benefit to the rate payer in that any expense which enabled us to hold our rates and our expenses at the existing level, was more favorable than one that might have compelled a rate increase.

• • •

(102) I should say that because it had an impressive effect on us and I think you are entitled to know it, that when we compared the difference between a $27.80 cost to the Georgia Power Company per kilowatt of capacity in the plant we were proposing, against a possible $16.50 per kilowatt of capacity in a joint plant under special financing, we also did not overlook the fact that we would get the total additional benefit of the difference in efficiency in the larger unit being (103) a 75,000 kilowatt unit as compared with a 66,000 kilowatt unit.

PRESIDING EXAMINER: You sound as though you still think you made a good contract.

THE WITNESS: I am quite sure we did make a good contract from the standpoint of cost to the Georgia Power Company. I wouldn't have made it if I hadn't.

• • •

(106) Q. With the benefit of hindsight, would you say that the company might have been in a better position so far as cost of production is concerned if it had constructed at the time you had that plant under consideration?

A. No, sir. I think the contract was good at the time it was made and I think it is still a good contract.

• • •

(114) Q. Do you know whether in fact your company, by reason of your 25-year contract with the Generating Company, does in effect, however, guarantee the payment of substantially more than half of Generating Company's total interest, amortization, taxes, and operation and supervision costs?

A. I don't know that and have no knowledge of what proportion of their total costs it is. The only thing I do know is this, that it is a saving to me. In my business, I am not adverse to somebody else making a profit if I can also make a profit for myself.

• • •

(125) Q. Did you know at the time whether they would have adopted the special financing if it had not been for your participation?

• • •

A. I certainly say this, and that is the reason I am a little embarrassed about these proceedings in addition to feeling that we made a good contract. I know, because my people sat in on some of those discussions, that investors who financed this plant took Georgia Power's contract into consideration in their willingness to finance this plant. So I was informed by my people, and I am therefore embarrassed and concerned if the contract should be altered or set at naught, for the impact—maybe I ought not to say this, but I am seriously concerned—that that might have on any future efforts to do what I understand this Commission would like to see these independent companies do, and that is integrate

their systems and build capacity one for the other wherever (126) it is cheapest.

Q. Then it is fair to say, is it, that you feel your participation made possible the financing and the method that was adopted and the construction of a two-unit plant?

A. The second unit. I think they could easily have financed on the H-bomb contract and their own service the one unit. They may have financed a two-unit plant, but certainly ours did enter into the willingness of the investors to finance the second unit. I think that is a fair statement.

Q. So your participation then did in effect make available to that system, Electric and Gas, benefits corresponding to your own from reduced costs of financing and from the economies of a two-unit plant.

A. Yes, sir, and I should say this to you, Mr. Wahrenbrock. We did what I thought was some right rough trading. We insisted that at some stage South Carolina would build a second unit in that plant anyhow. If we helped them finance the second unit, it would become the third unit and I think it is now under construction or contemplation.

We said to them, "Anything that you build into this first two-unit plant will have a value to your ultimate three-unit plant, and we want some concession based on that value." We were trading pretty close. We finally got around to what our engineers believed to be a reasonable allowance for that, and my recollection is that it was in the order of $200,000, and (127) allowance of costs, benefit or saving, on a third unit when and if it might be constructed.

We were gratified that in the final wind-up of the contract South Carolina recalculated and allowed us an additional $300,000 on that account. I believe it was $500,000.

Q. Perhaps I may suggest that it is now $581,000 instead of $200,000.

A. That is what I am trying to say. It went up some $300,000.

* * *

(130) Q. I am not passing any judgment on this.

When you say that your decision to purchase was based in part on the fact that special financing not available to Georgia Power Company was possible for Urquhart, why

wasn't the same method of financing available to Georgia Power Company?

A. One, we did not have the justification of the H-bomb plant which had produced such special financing, not only in this case but in Paducah; and I think since that time another case. We didn't have that angle.

But I would like to say to you, sir, that we had inquired of the Securities and Exchange Commission, which we are subject to and I am not sure South Carolina is, and we had applied to them about the possibility of some unorthodox financing for some of the tremendous amount of additional capacity we were having to build. We were told by the staff at that time that we could not construct. Why, I don't know.

I am a fellow who believes it might be advantageous to (131) the rate payer sometime to be a little less categorical in these ratios. But that doesn't seem to be the current regulatory thinking.

PRESIDING EXAMINER: You can't tell why. You just say you couldn't?

THE WITNESS: I don't know why they said it, but I know I would not have been permitted to do it.

* * *

(149) Redirect Examination by MR. ROBINSON:

* * *

(150) Q. I understand. Now you were going to give us some figures on the savings on energy. I wonder if you could give us those?

A. Maybe I am just volunteering, but I thought you would be interested in them. In addition to the differential in capacity cost, which I mentioned earlier, at the time of our estimates in May 1951, it appeared that fuel cost in the South Carolina joint plant, if constructed, would cost 3.27 mills per kilowatt hour against 3.50 mills per kilowatt hour in the 60 to 66,000 kilowatt unit we had in mind in the Augusta area.

* * *

(152) Q. You were about to give us the factors which in your opinion would justify a lower rate to duPont, had its

plant located in Electric and Gas territory than to a customer outside of that territory. What are those factors, Mr. Branch?

* * *

A. I was about to say that in setting a price for power to be sold to one to whom you bear no utility obligation, and therefore you have a complete freedom to serve or not serve, there are factors over and above the mere cost of generating and delivering the power.

For example, I think that my company, while it would be required not to differentiate in the cost of power toward customers of its own to whom it had each a utility responsibility, if they were taking the same class of service under similar and constant conditions, would nevertheless, if approached by someone to whom they had no utility responsibility, take into consideration the fact that the customer within their borders was contributing to the general economic level or the general economy which they served, that it might be in the case of a (153) large industry providing jobs, plants and purchasing power which might in turn be reflected in the ability of a number of persons within the utility's territory to buy and utilize larger amounts of electricity.

PRESIDING EXAMINER: Let me ask you right in that connection, now: Do you mean to imply—I am just trying to find out what you really mean there—do you also mean to imply that you haven't quite said that those very considerations might in turn advantageously affect future costs overall?

THE WITNESS: Yes, I think they would. And the ultimate cost of the utility company, as its economy builds up, the costs or the return to the utility in serving that area I think would be improved and the costs proportionately improved.

Exhibit 4

DIRECT TESTIMONY OF ALBERT H. GORDON

Q. Please state your name and address.

A. My name is Albert H. Gordon, and my address is 10 Gracy Square, New York, New York.

Q. What is your business background, Mr. Gordon?

A. I am a graduate of the Harvard Business School, and since 1931 have been a partner of Kidder, Peabody & Co. I have been a Vice President of the Investment Bankers Association, and a member of the Board of Governors of the New York Stock Exchange. I have testified before many tribunals, including the Federal Power Commission as an expert witness in security matters.

Q. What is the general background of the firm of Kidder, Peabody & Co.

A. Kidder, Peabody & Co. was founded in 1865, and has offices at 17 Wall Street, New York City, and additional offices in Chicago, Philadelphia, Boston, San Francisco and other cities. It is one of the leading investment banking firms in the country, and has engaged in considerable public utility work.

Q. Would you outline Kidder, Peabody & Co.'s financing experience with South Carolina Electric & Gas Company and its subsidiaries?

A. Of the present securities outstanding of the South Carolina Electric & Gas Company, Kidder, Peabody & Co. acted as banker in the public or private sale of all of the bond issues except one and all of the preferred and common stock issues. Kidder, Peabody also negotiated the private sale of one of the bond issues of the former South Carolina Power Company; $12,000,000 bond issue of South Carolina Generating Company in February 1954 and placed privately the original $4,500,000 bond issue in 1953, and the $4,000,000 refunding issue in 1954 of the South Carolina Natural Gas Company.

Q. Are you familiar with the original financing in 1951 of the South Carolina Generating Company in which the Company obtained commitments to sell $20,000,000 of First 3⅜'s 1979 and $4,000,000 of 4% notes due 1964?

A. Yes. The company negotiated this private placement directly with institutional investors.

Q. Would you give your opinion as to the contribution made by South Carolina Electric & Gas Company to the success of financing the Generating Company?

A. This financing in my opinion would have been impossible without the aid afforded by South Carolina Electric & Gas Company. The success of the Generating Company's financing and the favorable rates on its debt securities were due to:

(1) Affiliation with an established electric utility;

(2) Assurance provided by the parent company that additional equity funds would be made available as needed to complete the project;

(3) Guarantee by the parent of the debt principal and interest and related commitment fees during the period of construction;

(4) Guarantee by parent against any deficiency in insurance in the event that the station is destroyed or partially destroyed, and

(5) Assurance as to revenue to service the entire debt securities including sinking funds of the Generating Company plus a margin or cushion equal to 8% of the equity. In my opinion these commitments by the parent were essential to the successful placement of these securities.

Q. Would you state your opinion as to the effect on cost of financing of the South Carolina Electric & Gas Company which resulted from creation of a seprate Generating Company subsidiary and financing it as was done?

A. In my opinion investors regard the Generating Company being 100% owned as an integral part of the South Carolina Electric & Gas system. Investment bankers and institutional investors give considerable weight to consolidated statements in appraising all types of securities, bonds, preferred and common stock. This is particularly true of common stock. Many dividend restrictions are geared, as in this instance for example to the consolidated common stock equity ratio rather than to the ratio of the company alone. Security analysts generally employ the consolidated ratio when analyzing the investment position of a utility common stock. Inclusion of the Generating Company with its 90% debt capital resulted in the consolidated common stock equity ratio increasing only from about 26% in 1951 to about 28% in 1954 despite heavy common stock financing by the parent, while the common equity ratio of the parent increased from 26% in 1951 to 35% in 1954. In my opinion the effect on the

consolidated statement of including Generating Company subsidiary resulted in a higher cost of parent company bonds, preferred and common stock capital than otherwise would have prevailed, and it resulted in the need for unusually large common stock financing by the parent company.

Q. What do you consider to be desirable capitalization ratios for the South Carolina Electric & Gas Company?

A. In recent years we have witnessed a tendency on the part of utility companies to strengthen the ratio of common stock equity to total capitalization. In most cases this has been carried out despite a heavy amount of total financing requirements. At the end of 1953, the latest period for final industry averages, for Class A and B privately owned electric utilities as reported by the Federal Power Commission industry averages amounted to 49.8% for total debt, 12.8% for preferred stock and 37.4% for common stock and surplus. In our experience of financing utility common stock we have found the greatest frequency ranging from about 39% to 40%, and from our experience and conversations with institutional and individual investors, I would conclude that a ratio in the neighborhood of about 35% is desirable and generally acceptable.

Considering uncertainties engendered by present and possible competition from public power bodies in the territory served and the effect on operating costs of widely varying hydro electric output, I believe that South Carolina Electric & Gas Company should establish conservative capitalization ratios. In my judgment a common stock equity ratio of 35% would be appropriate.

Q. Do you have an opinion as to an appropriate ratio of debt in percentage of total capitalization for this Company?

A. Ratio of debt total capitalization is one of the most important elements in appraising the investment position of a utility company's bonds. While such ratios range all the way from about 40% to 60% the majority of cases fall within a range of about 45% to 55%. Many bond indentures specify 60% as a maximum of bonds to net plant additions. I believe it is important for a utility to strive for a conservative debt ratio and in my opinion it would be desirable to have as an objective a ratio of about 50% or less.

about 50% of total capitalization for debt
common stock, this would leave about 15% for
stock. Would you consider such a ratio to be a
for preferred stock?

Yes, I would.

Mr. Gordon, would you state how these capitalization
with the South Carolina Electric & Gas sys
at the end of 1951 and as to the effect
of such objectives would have on future

capitalization ratios to which I testified as de
ratios of 50% debt, 15% preferred stock and 35%
compare with actual company system ratios at
1951 of about 62.08% debt, 9.4% preferred stock
common stock.

evident as the system continues to expand the
must sell common equity amounting to more
net plant additions and preferred stock in ex
In order to reach such desired capitalization
of equity money is greater than debt money,
of financing will be greater than normal until
capitalization ratios have been attained.

Mr. Gordon, using present system capital ratios and assum
ratios to which you have testified as objec
will you give your opinion as to the amount of earn
to finance the continued growth of this system?

Based on experience in financing utility companies,
I believe that the amount of earnings needed to
meet the external requirements of this system is in
the neighborhood of 6% or more. Cost of raising capital for
the near future will for some years amount to
more than industry averages, in part because of
the need for creation of stronger capitalization ratios as
described, particularly common stock.

Q. Present and potential competition from public power
projects and

A. Widely varying hydro electric output.

The electric power industry as a whole earned about 6.2%
on net plant for 1951 based on Federal Power Com
mission preliminary figures for Class A and Class B utilities.

approximately the same percentage return as in 1953 based on final figures. This is exclusive of any consideration for working capital or pending applications for rate increases, allowance for which would probably still leave the earnings return at somewhat over 6%. In other words, funds for construction of existing electric plant have been financed based on earnings produced and allowed amounting to about 6% or more.

Q. Have you given consideration to other elements in arriving at estimated earnings requirements of 6% or more?

A. I have also considered cost of financing the company's individual components of capital, that is bonds, preferred and common stock.

Q. What is your opinion as to the cost of debt capital for this Company?

A. I believe that an appropriate allowance for debt cost would be in a range of about 3½% to 3¾%. Bonds of the company are now rated "Baa" and while a debt ratio of 50% or less should result in higher rating, capital costs are still likely to reflect the existence of potential competition from public power authorities and other factors previously mentioned. In recent years of unusual strength in the bond market, records shown by Ebasco Services, Inc. indicate that "Baa" utility bond offers have cost utilities which are predominantly electric net money rates ranging from about 3¼% to 4%.

Q. What would you estimate for cost of preferred stock capital?

A. Preferred stock capital for utility companies usually costs about ½% to 1½% higher than the cost to them of bond money. For this Company I would estimate a range of about 4½% to 5%.

Q. What would you estimate for cost of common stock capital?

A. With respect to common stock I believe that earnings of about 10% or more are needed to assure success of common equity financing.

Common stock investors are concerned largely with prospective earnings and consequently determination of costs of common stock capital must be based primarily on the rela-

tionship of prospective earnings and net proceeds from financing.

Earnings projections of $1.60 per share have been estimated by officials of South Carolina Electric & Gas Company in recent years at open meetings of the New York Society of Security Analysts and such estimates have been generally available to the public. In view of recent reported earnings, growth in the company's business and apparent prospects for continued expansion, I believe that the average investors buying the stock of this company do so on the basis of anticipated earnings of $1.60 per share or more. Recent market prices of about $19 for the stock are about midway between the high and the low for 1955 of 19⅞ to 17⅞. The subscription price of $17.50 at which additional stock was sold under rights to existing stockholders effective February 24, 1955 is approximately 8% under present market prices which is about average for underpricing in a utility company's rights offer. After allowing for underwriting fees and estimated company expenses the net to the company was about $16.90 per share. Anticipated earnings assumed at $1.60 amount to about 9.5% of net proceeds from the financing.

Q. Would you say that earnings of about 9.5% are sufficient under present market conditions to provide for common stock financing?

A. No. It is my opinion that 9.5% or more represents approximate minimum bare-bones cost of financing for this company under present market conditions. In order to provide reasonable assurance as to the successful financing it is essential to have an adequate margin of earnings, over and above the bare-bones cost of common stock capital to compensate among other factors for (1) Incentive for efficient and aggressive management and organization, and adequate and good service, (2) margin for possible error in calculating costs of capital, and (3) attrition or long term trend toward lower earned rates of return due to higher unit costs. In this instance provision for such a margin over bare-bones cost of capital would, in my judgment, require earnings amounting to about 10% or more under present market conditions. Present prices for utility common stocks are the best they

have been for the past 25 years or more and consequently I would regard an earnings requirement of 10% for successful financing for the company as a probable minimum.

Q. You have testified that the amount of earnings estimated to be required for reasonable assurance of successful financing under nearby market conditions is for bonds 3½% to 3¾%, preferred stock 4½% to 4¾% and common stock 10% or more. What would these rates of earnings amount to on an overall basis?

A. Assuming capitalization ratios at objective of 50% bonds, 15% preferred stock and 35% common stock, such rates of earnings on overall bases would range from about 5.93% to 6.09%. However, in order to attain consolidated capitalization ratios of 50% debt, 15% preferred and 35% common this company must finance over the next several years with larger proportions of equity securities, and, therefore, the overall rates of earnings needed to assure successful financing would be in excess of the range of 5.93% to 6.09%.

Q. What are your conclusions as to earnings necessary to provide the basis for successful financing of this system?

A. On an overall basis I believe that earnings of at least 6% are necessary to afford reasonable assurance for successful financing of the South Carolina Electric & Gas system in the near future.

CROSS-EXAMINATION OF MR. A. H. GORDAN

(158) Cross-Examination by MR. WAHRENBROCK:

* * *

(209) A. There is quite a difference between nullify, and "tend to nullify." I would say that it increased some of the costs for the system. I would doubt very much if it nullified it. The first obligation of the company is to furnish adequate service in its territory. By this method of financing it was enabled to render adequate service in its territory.

If it had not been able to take care of the AEC requirements, there might have been an adverse effect on the part of the investor towards the company.

* * *

(214) A. Overall, it seems to me to have been to the advantage of the company, looking ahead for its cost of money, to have built the Urquhart Plant. It was necessary to have this kind of capitalization in order to be able to get the AEC contract. Therefore, it was in my opinion in the interests (215) of the company to adopt this unconventional method for the advantage that it gave, and therefore it obviously should be the goal of the company to gradually achieve a conventional average equity base.

* * *

(342) MR. WAHRENBROCK: No further questions, Mr. Examiner.

PRESIDING EXAMINER: Georgia?

By Mr. Knowles Davis:

* * *

(343) Q. Does South Carolina Electric and Gas guarantee in any way the payment of the bonds which were issued by the Generating Company?

A. Yes, it has given assurance that there will be a sufficient payment for the bonds to take care of the interest and amortization.

* * *

(364) Q. You testified on direct that, based on your experience in financing utility companies, a return of about six percent or more would be required for this system, as your testimony reads. I am interested in what you mean by "this system." Do you mean on a consolidated basis of Electric Gas and Generating Company, or are you speaking of Electric and Gas by itself, or Generating Company by itself?

A. By the consolidated.

Q. In what way does an earning of six percent on a consolidated basis have an effect on the earning requirement of Electric and Gas?

A. That amount of earnings is necessary to make possible (365) the next financing.

* * *

(381) RE-DIRECT EXAMINATION

By Mr. Robinson:

* * *

(382) Q. Mr. Gordon, you were asked something about the variable earnings of the South Carolina Electric and Gas Company due in part at least to the water situation. Do you have the earnings per share of common stock over recent years? Would you read those into the record for us?

A. Yes. The earnings in 1946 were 80 cents a share; 1947, 74 cents a share; 1948, $1.33 a share; 1949, $1.36 a share; 1950, 70 cents a share; 1951, 52 cents a share; 1952, 90 cents a share; 1953, $1.15 a share; and 1954, $1.33 a share.

* * *

(385) RECROSS EXAMINATION

By Mr. Wahrenbrock:

* * *

(388) Q. If the Georgia Power Company contract had contained a provision permitting Georgia, we will say, on thirty months' notice to cancel its obligation to take and pay for the power, could the Generating Company have financed the two unit plant on as favorable terms as it did?

A. There would have been a slight difference in my opinion, unfavorable.

Exhibit 5

DIRECT TESTIMONY OF F. R. McMEEKIN

Q. Will you please state your name, address and occupation and the duties connected therewith.

A. F. R. McMeekin, 328 Main Street, Columbia, South Carolina. I am Vice President in Charge of Operations of the South Carolina Electric & Gas Company and Vice President and Director of its two wholly owned subsidiaries, South Carolina Generating Company and South Carolina Natural Gas Company. I am the responsible head of the Operating Department of the above named companies.

Q. What is your educational background?

A. After graduating from the public schools of Columbia, South Carolina, I attended Clemson College at Clemson, South Carolina and graduated therefrom in 1923, with a B.S. in Electrical Engineering.

Q. Are you a member of any engineering organizations?

A. Yes, I am a member of the American Institute of Electrical Engineers and the South Carolina Society of Engineers.

Q. Will you please describe your previous business experience.

A. Upon graduation from Clemson College in 1923, I was employed by Westinghouse Electric Corporation, at its East Pittsburg Plant, as a Test Engineer. In 1925 I joined the now South Carolina Electric & Gas Company as a Power Dispatcher. I then successively occupied the position of Chief Dispatcher, Superintendent of Transmission, Electrical Engineer, Superintendent of Power, Operating Manager and, in 1952, was made Vice President in Charge of Operations, the position which I now hold.

Q. Mr. McMeekin, what is your present connection with the South Carolina Generating Company?

A. As stated above, I am Vice President and Director of the South Carolina Generating Company, which is a wholly owned subsidiary of the South Carolina Electric & Gas Company. The South Carolina Generating Company will be sometimes hereinafter referred to as the "Generating Company."

Q. What was your responsibility in leading up to and the signing of the contract between the Georgia Power Company and the Generating Company?

A. In my duties as Manager of Operations of the South Carolina Electric & Gas Company, I participated in all discussions leading up to the contract in question between the Georgia Power Company (sometimes hereinafter referred to as the "Georgia Company") and the Generating Company. When the Generating Company was chartered, I was made President and Director and occupied this position at the time the contract in question was signed.

Q. Mr. McMeekin, will you supply background information as to the circumstances surrounding the negotiation of the power contract between the Generating Company and the

Georgia Company, especially as to the significance of the entry of Generating Company's negotiations with the Atomic Energy Commission and the results thereof. In this connection, please describe the special type of financing employed to construct the plant in question including the creation of a separate corporation.

A. In common with other electric utilities experiencing phenomenal growth in the post-war period, South Carolina Electric & Gas Company had been faced with the necessity of adding frequently to its generating capacity; in view of this condition, it had on order a turbo-generator unit, boiler and other plant equipment, the size unfixed, delivery of the unit being scheduled for August, 1952. Several sites for this proposed plant had been under consideration. With substantial steam electric facilities in the north and southeast extremities of its system, it had become apparent that the next such facilities should be located in the west-central area and extensive location studies had been made by the midsummer of 1950. Special consideration was given to a site near Branchville, South Carolina, since this location was particularly well suited for the South Carolina Electric & Gas Company's system and would result in minimum transmission loss. However, before definite site determination had been made, an announcement was made by A.E.C. that it expected to locate an enormous Hydrogen Bomb Project in the territory served by the Company, about fifty miles west of the Branchville site. Early in December, 1950, representatives of duPont Company, prime contractors for the Savannah River Project of A.E.C., contacted Electric & Gas officials in regard to construction and operating power supply for the Savannah River Project. They were advised that Electric & Gas then had on order a turbo-generator unit, and that it would build a plant of sufficient size to supply all of the A.E.C. power requirements.

Q. Mr. McMeekin, will you state whether or not you were actively engaged in a discussion with the duPont representatives concerning the possibility of evolving a contract for the power supply for the A.E.C. Svannah River Project.

A. I was, and from the outset of such discussions I was assigned the task of developing a satisfactory rate for such

power supply. On January 13, 1951, duPont was given an initial proposal for its operating power requirements.

Q. What was the reaction of the duPont representatives to the initial proposal insofar as rates quoted?

A. The duPont people indicated that the quoted rates were too high and that they were looking into other possible supplies, including the possibility of supplying all such requirements from their own plants. It was also sensed by *the* Company's representatives that the negotiations with duPont were being somewhat colored by arrangements *which* A.E.C. was making with Electric Energy, Inc. for its power supply at Paducah, Kentucky, and that a very important factor in the Paduch rate had been brought about by special financing for that project in which the ratio of debt to total capitalization was approximately 95%.

Q. What action resulted from the conferences with the duPont people?

A. We were advised by Mr. Costello, Executive Vice President and chief financial officer of our Company, that he believed some type of special financing, such as that which had been employed by Electric Energy, Inc., might be arranged to enable the Company to supply A.E.C.'s Savannah River Project power requirements on a favorable cost basis.

Q. Were studies made of such a financing approach, and if so, what were the results of these studies?

A. Yes, such studies were made. These indicated that with special financing a much more attractive proposition could be made for A.E.C.'s power supply. Accordingly, the Company submitted a proposition containing a rate based on special financing; this was satisfactory to duPont and resulted in the execution of a contract for a supply of power by Generating Company to the A.E.C. Savannah River Project.

Q. Mr. McMeekin, what brought about the negotiations with the Georgia Company which resulted in the power contract between that Company and the Generating Company?

A. The Georgia Company had become aware of our plans to construct a plant adjacent to the Savannah River Project Area and of the type of anticipated financing. Georgia Company officials advised representatives of Electric & Gas that they were contemplating the construction of a one unit

steam station near Augusta, and that they then had on order a 60/66 MW unit for use at that station. Consequently, it was suggested that a cost study be made, considering the feasibility of some arrangement whereby Georgia could secure its required capacity for the Augusta area from the Generating Company station, rather than construct its own plant, inasmuch as it appeared that with the special financing available to the Generating Company, a considerable saving would be available to Georgia Company.

Q. Mr. McMeekin, please explain methods used in determining economies resulting from the first two units of this specially financed plant, and indicate the savings to Georgia Company which presumably impelled Georgia Company to enter into the contract here under consideration.

A. In order to determine the overall economics of the two conditions and the possible saving to Georgia Company, under the two conditions, it was necessary to compare the plant cost and other cost factors under the two different propositions, that is, the plant as Georgia Company would have to finance it, and the plant as Generating Company planned to finance it. Estimated plant costs on these two bases were prepared by Gilbert Associates, Inc., engineering consultants for Generating Company, and by Southern Services, Inc., engineering consultants for Georgia Company. In general, these estimates were in fairly close agreement. Several meetings between the Georgia Company and its enginering representatives and the Generating Company and its engineering representatives were held during the spring of 1951 to resolve the differences in the estimates. Georgia representatives agreed to proceed with the cost comparison as based on Gilbert's estimate, increased by 15% to cover engineering interest, overhead and escalation. All other cost factors, such as cost of money, taxes, and operating expenses, etc. were discussed and accepted by both parties and an overall cost comparison was worked out and agreed upon.

Since these cost studies indicated large savings in favor of the common plant, Georgia representatives stated that they would be willing to enter into a purchase power contract, provided an greement could be reached as to an equitable split in the indicated savings.

Q. Please explain methods followed, and negotiations by which agreement was reached, as to charges to Georgia Company.

A. It was generally agreed that an equitable split in savings between the two costs would be the proper approach. It was the opinion of the representatives of both parties that a more equitable contract could be written if the contract were based on a two-part rate, namely, demand and energy. The demand charge was to be based on estimated plant cost and other fixed charges, including operating labor, with proper escalation provisions, and the energy charge was to be based on actual fuel and maintenance cost. After much negotiation and taking into consideration other factors, it was finally agreed that a capacity charge of $22.50 per KW per annum, based on the then estimated plant and other operating costs, would be an equitable one; this resulted in an estimated savings to Georgia in capacity cost of $5.38 per KW per annum, or a total annual saving of $403,500.

Q. Mr. McMeekin, you mentioned other factors considered which affected the capacity charges. What were some of these factors?

A. It was agreed that Georgia would obtain 75,000 KW on the high side of the station step-up transformer bank and since the guaranteed rating of the turbo-generator was 75,000 KW at its 13.2 KV terminal, the agreement to deliver 75,000 KW net to Georgia on the 115 KV side of the station step-up transformers represented a considerable concession. Station auxiliary and transformer losses normally run in the order of six to seven percent. Consequently, had the turbo-generator only produced manufacturer's rating, the then estimated cost per net KW per year would have been $16.30 under Generating Company's plan and $30.00 under Georgia's Plan, which would have resulted in a saving to Georgia of $7.50 per KW per annum, rather than the $5.38 mentioned above. It should be borne in mind that this situation regarding delivery of Georgia's share, as determined by 115 KV metering, also exists at times when there is a reduction in available capacity due to equipment outage. Consequently, Georgia's share is greater by the transformer losses under such conditions. These losses amount to approximately 458 KW under full load conditions.

Q. Are there any other benefits or savings, other than those above mentioned, resulting to Georgia in its contract, as compared to conditions under its own one unit station?

A. Yes, there are several:

1. The overall efficiency of this plant is approximately 10% higher than that proposed by Georgia. Consequently, fuel consumed per KWH is approximately 10% less.
2. No fuel tax applicable as contrasted to a three percent tax on fuel burned in Georgia.
3. If Georgia Company had constructed a one unit station at Augusta, as they proposed, they would have suffered a 100% loss in capacity, with its attendant voltage troubles in the event of an outage of this unit, whereas under the contract with Generating Company, they have only 50% loss in event of outage of one unit and it would be very improbable that they would ever suffer 100% loss of capacity.
4. Reduction in maintenance cost due to maintenance allocation being on a kilowatt-hour basis produced is another saving. Since the plant production is considerably higher than that proposed on the Georgia plant, the unit maintenance cost will be correspondingly lower.
5. Under the Georgia ownership plan, it would have been necessary for Georgia to maintain minimum load requirements during certain off peak hours when it would not have been economical for them to do so, whereas under the Generating Company contract they are allowed to reduce their take below minimum load requirements on steam units provided other loads on steam units are sufficient to make up this deficit. This factor has proven of considerable advantage to Georgia.

Q. Mr. McMeekin, what is your estimate of the annual saving to Georgia resulting from fuel and maintenance saving under the Generating Company plan?

A. Based on present day fuel cost and present load factors of the Georgia load, it is estimated that the savings accruing to Georgia would be in the order of $175,000 to $200,000 annually. This is in addition to the savings of approximately $403,000 per annum in capacity cost.

Q. Under the terms of the Georgia contract, does the Generating Company give credit to the Georgia Company for plant cost chargeable against future expansion?

A. Yes, under the terms of the contract, it was agreed that if the Generating Company installed additional capacity at the Urquhart Station, the plant cost of the station, on which the Georgia Company is charged, would be reduced by $200,000, becoming effective at the beginning of the first month following the month in which additional capacity is ready for commercial operation.

Q. What voluntary action has the Generating Company taken in respect to this provision?

A. Further studies by Generating Company indicated that the amount credited to future extensions would be raised to $581,000 and Generating Company volunteered further to make adjustment in this allowance from the initial billing date rather than defer such adjustment until the actual commercial operating date of the additional capacity, which now appears will be some time in the latter part of 1955. In other words, the Generating Company has not only voluntarily increased their allowance for future expansion but allowed such credit to start approximately two years prior to the date covered under the agreement.

Q. What would have been the situation in regard to like expenditures for future plant expansion had Georgia Company built its own plant?

A. It is reasonable to assume that Georgia would have made expenditures for future plant expansion, which cost they would have had to have borne in addition to cost strictly allocable to the first unit. These costs were not included in cost comparison shown in Exhibit 4.

Q. What has happened to Generating equipment, construction, and other cost factors since 1951, the date at which the Georgia contract was negotiated?

A. All construction costs and other costs have risen.

Q. How much has the increase in plant investment cost, and other cost factors affecting Generating costs, been since 1951?

A. Insofar as the Urquhart Station of the Generating Company, this increase has amounted to something above 15%.

Q. Would it be fair to assume that the same cost factors would have affected the cost of the proposed Georgia plant, had it been constructed?

A. Yes.

Q. What has been the affect of these increases on the cost to Georgia on its contract with Generating Company?

A. Assuming that 15%, even though it actually has been slightly higher than this, the increase in cost to Georgia would have been $2.30 per KW per annum.

Q. What would have been the amount of the increase if the same 15% was applied to the 1951 estimated Georgia plant cost?

A. This would have resulted in an increase of $1.18 per KW per annum.

Q. What would have been the additional indicated saving resulting from the Georgia contract with the Generating Company?

A. $1.88, which, added to the original 1951 indicated saving of $5.38, would make a total indicated saving as of 1955 of $7.26 per KW per annum.

Q. Were there any factors detrimental to the parent company, Electric & Gas Company, which were brought about by the contract with Georgia?

A. Yes, the most serious being that the control and regulation of flow of energy from the Urquhart Station into the Georgia system is the responsibility of the Generating Company and, in turn, the Electric & Gas Company. This difficulty and responsibility necessitated the isolation of equipment serving Georgia since phase angle difficulties exist during deliveries by Electric & Gas to Duke Power Company or Carolina Power & Light Company. In order to overcome the power flow control difficulty, the Generating Company must either isolate a unit on Georgia, or Electric & Gas must isolate a portion of its system from its other interconnections. Therefore, when one of the Generating Company's units is out of service, Electric & Gas must either lose its share of capacity from the Generating Company or split its system at another point, thereby losing capacity and operating economies at its other stations. Electric & Gas must either continue to suffer the losses brought about by such operations, or, to overcome this condition, it will be neces-

sary to install phase shifting equipment at an estimated investment cost of $600,000. This phase shifting equipment would consume approximately 375 kilowatts of power. Therefore, the total annual investment maintenance, and operating cost would exceed $100,000.

Q. You previously stated that the Generating Company type of financing was basically brought about in order to supply A.E.C. with its outside power requirements at the lowest possible cost. Is that correct?

A. Yes.

Q. In order to secure the A.E.C. contract, was it necessary for the parent company, Electric & Gas, to make certain burdensome commitments, thereby to enjoy the benefits from the construction of the Generating Company's station, the cost of such burden reducing the value of the contract between it and the Generating Company?

A. Yes.

Q. Will you outline some of these adverse factors.

A. 1. It was necessary for the Electric & Gas to make certain improvements in its transmission system so that service to A.E.C. would be of unusually high quality.

2. It was necessary for Electric & Gas to guarantee deliveries to A.E.C. under certain conditions. In case of an outage of one unit, such guarantee would result in an 83% loss of its contracted for capacity, of 45,000 KW, whereas such a one-unit outage would result in only 50% loss for the Georgia Power Company.

3. It is also the obligation of the Electric & Gas to continue to supply the Generating Company's commitments to A.E.C. in event of outage of both units' other than that of a force majeure type of outage. Under this commitment, Electric & Gas not only suffers 100% loss in its contracted for capacity with the Generating Company but also is committed to furnish 30,000 kilowatts of capacity to A.E.C.

Exhibit 2

DIRECT TESTIMONY OF W. J. READY

Q. Please state your name, address and occupation.

A. My name is W. J. Ready, and I am Controller of the South Carolina Electric & Gas Company ("Electric & Gas") and its wholly-owned subsidiary, South Carolina Generating Company ("Generating Company"), respondent in this case. My office is at 328 Main Street, Columbia, South Carolina.

Q. How long have you occupied these positions?

A. I have been Controller of Electric & Gas since 1943, and Controller of Generating Company since shortly after its inception in 1951. Practically all of my professional career over many years has been one connected with public utilities.

Q. What is your professional education?

A. I am a graduate of the University of South Carolina in the class of 1923 with an A.B. degree in economics. I am a certified public accountant, and a member of the American Institute of Accountants, and the South Carolina Association of C.P.A.'s.

Q. Are you familiar with the contract here under consideration?

A. I am indeed very familiar with this agreement. I supervised practically all of the accounting studies made in connection with the Generating Company and its Urquhart Station, as well as the studies made on this contract. I was a member of the committee which negotiated this agreement.

Q. Tell us whether or not you are familiar with the two statements filed as exhibits 1 and 2 to respondent's answer in this matter dated January 15, 1955.

A. I am.

Q. Briefly discuss the basis of the statements.

A. These two statements identified as exhibits 1 and 2 reflected projections of costs to serve Georgia Power Company and revenues from Georgia Power Company for the 25-year term of the contract. Both statements were necessarily based upon estimates of plant costs, expenses, taxes and other factors.

It may be helpful in interpreting those statements if we start with a brief resumé of the contract terms and then touch upon some of the items such as taxes which required special handling in the statements.

The base rate of the power contract to Georgia Power Company, by which I mean the charges other than the 87.20 component which is under review in these proceedings, is designed to cover the costs of rendering the service, including components for financing, fixed operations, and energy. The term "cost" as contemplated by the parties to the contract has reference to the outlays necessary to do the job rather than the term as it may be used in an accounting sense.

Q. Describe for us the finance component of the contract capacity charge.

A. The finance component of the capacity charge is designed to service the debt and the equity investment to serve Georgia Power Company. The rate was derived on the basis of 90% debt capital and 10% equity capital, with level annual charges sufficient to provide interest on and amortization of the assumed 90% debt in 25 years and a return of 8% on the assumed 10% equity. The sum of these produced a factor of 6.46%, which, applied to the then estimated total cost of $21,100,000, including $1,000,000 for working capital, resulted in a level annual cost which was rounded out to $10.50 per kw and subjected to an escalation formula for variations between the estimate and the actual investment.

An estimated total initial plant cost of $27,671,900 was used in the statements filed with the Commission on January 15 previously referred to and the Company has more recently established a figure of $27,573,700 for this purpose.

Q. What is the operations component of the contract capacity charge?

A. This component is designed to cover operating, general and administrative expenses and taxes other than such items as are included in the energy charge. Taxes on income are included in the operations component and I would prefer to discuss them separately. The operations component was originally estimated at $1.80 per kw, based upon then estimated expenses and taxes of $720,000 per annum, subject to escalation for variations from actual. Estimated expenses

and taxes of $901,392 ($6.05 per kw year) for the partial 1954 period were used in arriving at the revenues of $428,930 used in Statement No. 2, which is the projection of revenues filed with the Commission and referred to at the beginning of this testimony. This total has subsequently been determined to be $896,263 ($6.02 per kw year), producing revenues of $426,641.

Q. What energy charge is provided for in the agreement?

A. The energy charge includes the cost of fuel, maintenance, and related taxes and is increased by the average of such costs per kilowatt-hour. Statement No. 2, which is the revenue projection filed with the commission previously referred to, shows for the partial year 1954 an estimated energy charge of $801,824 for 255,351,000 kilowatt-hours, or an average of $.00315 per kilowatt-hour, whereas the actual amount has subsequently been determined to be $.00316 per kilowatt-hour.

Q. Tell us whether or not there is any additional capacity charge in this contract.

A. There is

Q. Please elaborate on this.

A. The contract provides for an additional capacity charge of $7.20 per kw which is not related to any costs to be found on the books of South Carolina Generating Company. This amount was negotiated as a sharing between Generating Company and the Georgia Company of substantial economies estimated as accruing to the Georgia Company under the contract as compared with the construction and operation of a generating station of its own. These substantial savings are primarily attributable to the assumed 90% debt financing from which Georgia derived the benefit, and it should be borne in mind that the parent company, if we brush aside the artificialities of corporate entity, is actually the vendor which financed this project and in so doing the parent had to provide equity leverage for this debt. In other words, there are costs on the books of the parent company which should be taken into account in addition to the costs to be found on the books of Generating Company, and these costs may be roughly measured by the spread between the cost of servicing equity capital and the average cost of servicing total capital to the extent that capital funds of the par-

ent company had to be provided exclusively from equity to provide such leverage.

Q. Tell us whether or not the contract provides a special formula for the determination of taxes on income as related to billing in the operations component.

A. It does.

Q. Please describe this.

A. Basically, such taxes are those which relate to the concept of income employed in the contract. In other words, if the tax is on net income with interest allowable as a deduction, the amount to be billed for such tax would be the amount of the required revenues, which, after the deduction of the tax, would leave the 8% on the assumed 10% equity capital. In order to achieve this, the contract provides for the substitution of the interest element of the finance component as the deductible interest, and the substitution of the amortization element of the finance component as the deduction for depreciation. These substitutions would only be made in case interest and/or depreciation are deductible items for purposes of computing the tax under consideration. Thus, it is apparent that an election to adopt accelerated amortization for tax purposes, or to refinance, or an acceleration in retirement of debt, will have no effect on the billing for taxes. Other technical provisions are included to assure conformity with these principles. Any tax on income arising from the payment by the Georgia Company of the $7.20 per kw additional capacity charge would not be passed on to the Georgia Company.

Q. Tell us how this matter was handled in the cost statement.

A. The computation of taxes on income included in the projection of the cost to serve the Georgia Company, which is Statement No. 1 filed with the Commission on January 15, 1955, is related to the assumed 6% return on the net investment. For this purpose it was assumed that the deduction for interest would not be the amount of interest to be paid by Generating Company, but would be the interest payable by Generating Company if its debt were 50% of its capitalization, consistent with capitalization ratios implicit in the 6% return. As alluded to previously in the discussion of the additional capacity charge, the dislocation in the capital struc-

ture of the parent company will have resulted in a disproportionately high equity ratio with a correspondingly low debt ratio and the loss of interest deductions in computing its income tax, to the extent of the difference between actual interest of Generating Company and the interest used in computing the tax element in its cost to serve. The result is essentially the *system* tax.

Q. State whether or not Generating Company holds any Certificates of Necessity in connection with the first two units at the Urquhart Station permitting what is commonly referred to as accelerated amortization.

A. It does hold such a certificate.

Q. Briefly describe this certificate and tell us whether or not it has any effect on billing.

A. Generating Company holds a Certificate of Necessity permitting it for tax purposes to amortize over a period of 60 months approximately $11,500,000 of facility costs for Units 1 and 2 at the Urquhart Station. As previously indicated in the discussion of taxes on income, the Georgia contract does not contemplate any effect upon billing as a result of a decision to obtain the tax deferment benefits of accelerated amortization.

Q. Now tell us how this item was handled in the cost statement.

A. In computing the taxes for inclusion in the cost to serve statement filed with the Commission, referred to previously, provisions for future taxes are included to the extent that provisions for current taxes are reduced by the estimated effect of the assumed use of accelerated amortization deductions. This, we believe, is consistent with Opinion No. 264 of the Commission to the effect that the use of accelerated amortization deductions in tax returns should not operate to affect rates, and is in reliance upon that opinion. An election with respect to the use of such deductions is not required until the filing of the tax return for the year 1955, and if such an election is made, the Company can elect to terminate its use at any time thereafter.

Q. What depreciation rate was employed in the cost statement?

A. A 3% depreciation rate has been used.

Q. Discuss this rate for us.

A. This rate does not purport to be the maximum reasonable rate for this purpose. Time may well disclose that it is inadequate. It is about one-fourth of 1% higher than the rate being recorded on the books and the rate being used by Electric & Gas for substantially similar property. However, for purposes of this proceeding, with a 25-year projection in view, it is my opinion that the hazards of infant mortality, due to the proximity of the site to the hydrogen project, and of obsolescence due to recent development in nuclear fuels, should receive more weight than are presently given from year to year on the books. It should be borne in mind that Georgia Power Company apparently regarded it as good business to contract for power at rates which amortize 90% of the cost in 25 years.

Q. Tell us whether or not the parent company made any commitments in connection with the Urquhart Station.

A. It certainly did.

Q. Elaborate on this.

A. As sponsor of the Generating Company and as one of its three power customers, Electric & Gas had made a number of very significant commitments to purchasers of project securities, vendors, and to Generating Company, which are of very great value to the latter company and of potentially great cost to Electric & Gas. Although it is difficult to assign a monetary value to these intangible contributions by the parent company, they should be given due weight, together with the more measurable costs arising from the previously mentioned displacement in capitalization ratios, in any comparison between the rate to Georgia Power Company which includes the $7.20 per kw additional capacity component and the rate to South Carolina Electric & Gas Company which does not.

Q. Please indicate some of these commitments.

A. The parent company initiated a number of major equipment orders and remained as a contracting party after Generating Company was organized.

In bond and note purchase agreements the parent company guaranteed the payment of commitment fees, if the securities were not sold.

In bond and note purchase agreements the parent company was obligated to provide any excess funds required to com-

plete the station or upon failure to do so to provide sufficient funds to redeem outstanding debt.

Under the Indenture and note purchase agreements the parent company is guarantor for the payment of principal and interest on bonds and notes until after certain earnings conditions are met for twelve consecutive months of operations.

Under bond purchase agreements the parent company agrees to make up any deficiency in insurance in the event that the station is destroyed or partially destroyed.

In the parent company's power purchase contract with Generating Company, the parent is obligated to supplement its payments for contract capacity to the extent necessary to provide an eight per cent return on Generating Company equity after expenses, taxes, interest and debt amortization.

In this power contract the parent agrees to be responsible for any contract capacity reduced or cancelled by any of the other contracting parties, and in the event of such cancellation at the request of the parent company, to pay for such capacity at the same rate as the party relinquishing same.

Under this power purchase contract the parent company is also obligated to successors or assigns of Generating Company.

Under the power contract between Generating Company and duPont, to which the parent company is a party, the parent company is obligated to supply any deficiency in electric service to duPont unless such deficiency results from force majeure.

Q. Have you prepared any figures showing, by years, a comparison between the contract return and a return on a straight 6% basis?

A. I have, and this is attached as Exhibit VI.

Q. Would you care to make any comments on this exhibit?

A. Yes, I would. You will note that considering this purely on an annual basis a 6 per cent return is not reached until 1962. On a cumulative basis this 6 per cent return is not reached until 1970.

Exhibit 3

ADDITIONAL TESTIMONY OF W. J. READY

Q. Do you have a statement showing changes in capitalization of South Carolina Electric & Gas Company and subsidiary companies during the period when the first two units at the Urquhart Station were being financed?

A. Yes, *Statement 4* (Exhibit VII) reflects changes in the capitalization of the system during the period from 1951 through 1954 on a consolidated basis and for each company.

Q. What trends does this statement show in capitalization ratios?

A. At the end of 1951 the consolidated capitalization ratios were the same as the ratios for the parent company; namely, 63.25% debt, 10.87% preferred, and 25.88% common equity. There was no subsidiary at that time. By the end of 1954 consolidated ratios were 62.83% debt, 9.40% preferred, and 27.77% common equity. It is therefore apparent that there was some improvement in the common equity ratio during the three-year period represented by the increase from 25.88% at the end of 1951 to 27.77% at the end of 1954. However, by the end of 1954 the parent company equity ratio had risen from 25.88% to 35.01% and its debt ratio had dropped from 63.25% to 52.64%.

Q. To what do you attribute the 1954 deviation between the parent company and consolidated ratios?

A. This is attributable to the necessity for the parent company to provide equity leverage for the debt capital of its subsidiaries. It was necessary for the parent company to provide funds for investment in common stock of the subsidiaries. It was also necessary for the parent company, in order to prevent a drop in the consolidated common equity ratio, to provide a disproportionate amount of its own new money requirements by the sale of equity securities or the retention of earnings. In other words, by the end of 1954 for every dollar of subsidiary capitalization there would have to be 27.77¢ of equity somewhere on the system to attain a 27.77% consolidated common equity ratio and to the extent that this 27.77¢ had not been provided by subsidiary earned surplus we must look for it on the parent company. Perhaps

the point can be more clearly made by observing that the 27.77% common equity is about 44% of the 62.83% debt ratio so that for each dollar of subsidiary debt the system had 44¢ of equity, the most of which was to be found on the books of the parent company.

Q. Would you say that this increase in parent company equity is entirely caused by the need to provide leverage for the debt on the first two units of the Urquhart Station?

A. No, the debt in connection with the third unit at the Urquhart Station and the debt in connection with the pipeline of South Carolina Natural Gas Company, were involved. However, as the debt in connection with the first two units at the Urquhart Station was in excess of $23,000,000, whereas the debt in connection with the third unit and the pipeline aggregated only about $8,000,000, it is evident that the leverage requirements of the first two units at the Urquhart Station constituted the principal cause of the disproportionate increase in parent common equity.

Q. You pointed out that the consolidated common equity ratio improved during the 1951-1954 period. Is this raising of the consolidated common equity ratio also partly responsible for the disproportionate increase in common equity of the parent company?

A. That is true only to the extent of the rise in parent company equity from 25.88% to 27.77%, but the parent company equity increase beyond the 27.77% to 35.01% was for leverage purposes.

Q. Do you have a statement which shows what percentage of the 1951 to 1954 increase in parent company capital is common equity?

A. Yes. *Statement 4 (a)* (Exhibit —) summarizes the changes in parent and system capitalization during the three-year period and shows that approximately 72% of the increase in parent company capital from 1951 through 1954 was common equity. Only about 10% was debt capital and about 18% was preferred.

Q. How do these net new money capitalization ratios for the parent company compare with the new money ratios for the system?

A. On a consolidated or total system basis the increase in common equity was about 31%, compared with 72% for

the parent company. New debt for the system was about 62%, compared with 10% for the parent company. New preferred was about 7%, compared with 18% for the company.

Q. To what then do you attribute this high equity ratio for parent company new money during this period?

A. It is very largely due to the very substantial debt financing during the same period by Generating Company.

Q. Do you have any information as to capitalization ratios of privately-owned electric utilities in the United States?

A. Yes, we have prepared *Statement 5* (Exhibit —) showing the capitalization of such companies as are classed A and B as reported by the Federal Power Commission for the years 1951, 1952 and 1953 in publications entitled "Statistics of Electric Utilities in the United States."

Q. Would you comment on the ratios shown by this statement?

A. We have computed common equity as 37.40% at the end of 1953. It was 38.28% at the end of 1952 and 37.33% at the end of 1951. Preferred ratios ranged from 13.45% to 12.77% from 1951 to 1953, and the debt ratio was 49.22% at the end of 1951, 48.68% at the end of 1952 and 49.83% at the end of 1953.

Q. Do you have any information as to the earnings of privately-owned electric utilities and the ratio of operating income to net plant in recent years?

A. Yes, on *Statement 6* (Exhibit 3) we have shown information derived from Federal Power Commission Release No. 7828 covering the earnings and plant accounts of privately-owned electric utility companies for the year 1954.

The release from which this data was derived points out that electric utility operating income for 1954 was approximately 6.2% of average net plant and was virtually unchanged from 1953. After including an estimated allowance for materials and supplies and working capital it is unlikely that the return would be less than 6%.

Q. Have you made a projection of money costs for the 25-year period covered by the Georgia contract?

A. Yes, we have made such a projection on *Statement 7* (Exhibit 3).

Q. Explain generally how this statement was developed and the money costs which it discloses.

A. We began with the total capitalization at the end of 1951 amounting to approximately $84,516,000 broken down between debt, preferred and common as previously discussed in connection with Statement 4 (Exhibit VII). This total capital is shown as increasing each year until it amounts to $138,612,000 by the end of 1954. The increase in 1955 is based on current forecasts. Thereafter the annual increase in capitalization is based upon an assumed 10.3% straight line increase from year to year. This factor was derived from a trending of actual increases occurring in net plant accounts from 1945 through 1955 as shown on the supporting *Statement 7(a)* (Exhibit 3) and is the ten year compound average increase. It might be noted that in the last six years of the period the plant account increased each year more than 10%. The supporting statement has been adjusted to exclude the portion of the investment in the first two units at the Urquhart Station devoted to the service of Georgia Power Company, as we were attempting to measure growth for territorial service only.

Q. Explain the method used to allocate growth capital requirements between debt, preferred and common categories on Statement 7.

A. From 1951 through 1954 the allocation is actual. For 1955 it follows current estimates. For subsequent years it is designed to gradually elevate the consolidated equity ratio to 35% and the preferred stock ratio to 15% which results in a drop in the consolidated debt ratio to 50%. In this projection the common equity ratio reaches approximately 35% in 1960 and the preferred reaches 15% in 1961.

Q. Based on the projected growth capital and the capitalization ratios which you have mentioned, how were these used to arrive at the annual cost of money for the years shown on the statement?

A. For each year shown, the total annual finance cost is the sum of the annual costs shown for debt, preferred and common. In the case of debt, the 1954 annual cost is based on actual rates for growth capital in use during that year. Beginning in 1955 we have assumed that the rate for additional new money will be 3.625%. In the case of preferred, the

actual cost has been used for 1954 and the rate for subsequent years' additional preferred after 1955 is assumed to be 4.60%. In the case of common we have assumed a cost of 10% per annum. The weighting for future years' additions is based on the assumption that the increment each year will be utilized on an average for only six months.

Q. What is the significance of the tax columns on this statement?

A. The tax columns are provided to show the taxes on income which correspond to the annual cost shown for each category of capitalization. The state tax rate is 4½% and the Federal tax rate is 52%. The state tax does not recognize interest as a deduction. The state tax is deductible in arriving at Federal taxable income. The factors shown are pyramided to include the tax arising from the collection of revenues to provide for payment of income taxes. In other words, the taxes shown are the amounts which added to the annual finance cost will, after the deduction of taxes, leave the annual finance cost as a remainder.

Q. What is the range of weighted total annual finance rates in terms of percentages of capital?

A. The 1954 finance rate or cost of money shown on the statement is 5.6794% and the corresponding tax factor is 3.6869%. Weighted finance rates range upward to a peak of 6.3536% in 1961 at which time the corresponding tax factor is 5.6207%.

Q. You have previously referred to Statement 7(a) showing ten year growth in net plant investment for the South Carolina Electric & Gas Company system in support of your growth assumptions on Statement 7. Do you have any other support for the assumptions used in Statement 7?

A. Yes, in addition to Statement 7(a) which shows the ten year growth trend in net plant we have prepared *Statement 7(b)* (Exhibit 3) which shows for the 1945 to the 1954 period the trend in sales of electricity to ultimate consumers. The annual percentage increases on this statement are even more impressive than the annual increases in net plant, being above 10% in all but two of the nine years and averaging in the neighborhood of 12% per annum.

Q. In Statement 7 and supporting statements you have been dealing with the cost of money to the South Carolina

Electric & Gas Company system rather than to South Carolina Generating Company. Do you have any statement which demonstrates the relationships between system finance costs and finance costs which are related to and chargeable against the first two units at the Urquhart Station?

A. *Statement 7(c)* (Exhibit 3) entitled "Segregation of System Capital and Related Annual Costs Between the First Two Units at Urquhart Station and the Remainder of the System" is designed to demonstrate why the weighted average system cost of money, rather than the cost to be found on the books of the Generating Company, is the proper measure of the costs to the system in connection with the two unit project at the Urquhart Station. For this purpose we have taken the year 1961 as representative. The statement is divided into four sections, the first section showing the system growth capital in use during 1961, the cost of which including related taxes is 11.9743%. The second section shows the capitalization of Generating Company in that year applicable to the first two units at the Urquhart Station. Due to the preponderance of debt, the average cost on the basis of capital ratios to be found on the books of the Generating Company is 9.1868%. The third section is headed "Displacement" and refers to parent company capital which is displaced, or out of its normal capitalization ratio position, if we consider the system capitalization ratios as normal for that year, due to the necessity of providing leverage for the capital of the Generating Company in connection with the first two units. The fourth section entitled "Non-project" represents system capital which is unaffected by the project financing. Thus the statement shows system growth capital of approximately $178,000,000, project capital of about $23,000,000, non-project capital of about $140,000,000 and approximately $14,000,000 of capital in limbo, that is, occupying temporarily an in-between status wherein the money is actually used for non-project purposes, but its cost is abnormal due to the influence of project financing. Therefore, we have allocated a part of the annual cost to the project and a part to non-project use. The amount allocated to non-project use is the normal or average system cost of such capital measured by applying the average system rate to the total dollars. The remainder, which amounts to $650,000, is the

excess of cost for such capital arising from project financing. This is the detriment to be found in the costs of parent company capital and we have applied this amount as an additional cost for units 1 and 2. The result of adding $650,000 to the $2,142,000 of cost previously determined results in a total of $2,792,000 of system costs for Generating Company capitalization for units 1 and 2 for the year 1961, resulting in a composite rate of 11.9744% which is substantially the system rate, the minor difference being obviously due to dropping fractions. If we apply this rate to the rate base applicable to Georgia, we have a return and related tax of $1,324,452. Page 2 of Statement 7(c) makes a similar determination for the year 1954.

Q. Do you contend that the cost of money is the measure of the rate of return reasonably allowable in connection with the service to Georgia Company?

A. Not necessarily, as there are other costs which should be considered, including those imposed upon the parent company of an intangible nature such as its acceptance of risks and obligations to accomplish the financing. These should be taken into account and would justify a return somewhat above the bare cost of money. Obviously the cost of money establishes a minimum requirement.

Q. Have you applied these money costs to the rate base to serve Georgia and established costs for comparison with revenues under the contract?

A. *Statement 8* (Exhibit 3) has been prepared for this purpose. It is simply a substitution of required return and related taxes at the system costs of money developed on Statement 7 in lieu of the 6% rate of return and related taxes shown on Statement 1 which has been identified as Exhibit I. It was necessary to develop depreciation, operating expenses and other taxes for intervening years not shown on Statement 1 and this is reflected on *Statement 8(a)* (Exhibit 3).

Q. On Statement 3 which is Exhibit VI you presented a comparison between cost to serve on the 6% basis and contract revenue. Have you developed a similar statement comparing the cost to serve on the projected actual money cost basis with contract revenues?

A. Yes, this is done on *Statement 9* (Exhibit 3).

Q. Please discuss the results shown on Statement 9 in relationship to the results shown on Statement 3.

A. As previously stated with reference to Statement 3, contract revenues are not sufficient to cover 6% costs until 1962, and, on a cumulative basis, the deficiency in recovery of 6% costs is not made up until 1970. The results on Statement 9 are not materially different, as that statement shows that contract revenues are not sufficient to cover system costs on the projected actual finance cost basis until 1964, and the accumulated deficiency of revenues under costs on the projected actual finance cost basis is not covered by contract revenues until 1971.

Q. Have you prepared a statement to demonstrate the mathematics involved in establishing the deficiencies in contract revenues below amounts required to cover necessary return and taxes on the two bases you have mentioned; namely, the 6% money cost basis, and the actual system cost of money basis?

A. *Statement 10* (Exhibit 3) based on the year 1961 selected as typical was prepared for this purpose. You will note that the deficiency of $29,698 in return and taxes shown on the line 8 for the 6% cost basis, agrees with the rounded out figure of $30,000 deficiency appearing on Statement 3 and that the deficiency of $133,744 shown on line 8 on the actual projected cost basis, agrees with the rounded out figure of $134,000 shown for 1961 on Statement 9.

Q. Have you prepared earnings statements to demonstrate the effect of the assumed returns and taxes shown on Statement 10?

A. Yes, *Statement 11* (Exhibit 3) reflects the taxes, the over-all return and the equity return for each of the columns appearing on Statement 10. It also proves the soundness of the tax figures.

Statement 4(a)

SOUTH CAROLINA ELECTRIC & GAS COMPANY AND SUBSIDIARY COMPANIES

Summary of Changes in Capitalization (1) 1951—1954

CHANGES
(Thousands of Dollars)

	1952	1953	1954	Totals	Ratios
Parent					
Debt	$ (930)	$ 3,657	$ (662)	$ 2,065	9.85%
Preferred	(75)	(75)	3,990	3,840	18.32
Common	4,865	5,443	4,749	15,057	71.83
Totals	$ 3,860	$ 9,025	$ 8,077	$ 20,962	100.00%
Consolidated (System)					
Debt	$ 10,110	$ 19,617	$ 3,912	$ 33,639	62.18%
Preferred	(75)	(75)	3,990	3,840	7.10
Common	4,937	5,664	6,616	16,617	30.72
Totals	$ 14,972	$ 25,206	$ 13,918	$ 54,096	100.00%

(1) Condensed from Statement 4 (Exhibit VII).

WJR/OSW
4-15-55

CROSS-EXAMINATION OF MR. W. J. READY

(597) By Mr. Wahrenbrock:

• • •

(636) Q. By external, did you have in mind bombing or other enemy action on the one hand, or some catastrophe originating in connection with the particular activity carried on in the AEC's Savannah River project?

A. Mr. Wahrenbrock, I don't want to be put in the position of reflecting on the judgment or wisdom of the powers that placed a project of that sort in our midst. It is perhaps due largely to the lay attitude towards the term "nuclear reaction", but with that qualification, I would say that (637) it seemed to me, in common with others of my associates, that the nearness of the Savannah River project of the AEC constituted more than a normal hazard, both by reason of the hazards of bombing and other hazards that might possibly occur in the handling of nuclear materials.

I admit I am not a scientist, and I am not in a position to say what protective steps have been taken by AEC to prevent anything of that sort.

• • •

(650) But in this case particularly the equity funds on which interest was capitalized came from the parent company and almost necessarily came from the equity component of the parent's capital.

• • •

Of the funds received by the parent company from outside sources, the timing of the debt money and the timing of the preferred new capital coming into the hands of the parent company is such that it is most unlikely that any significant amount of it—if any at all—could have been utilized in the construction of this project.

• • •

(651) I think we were influenced also by the fact that in the contract 8 percent was specified as the return on equity during the operating period; and there seemed to us to be no (652) less risk during the construction period than during the operating period.

• • •

(670) Q. The importance of these contracts and the negotiation of these contracts to the enterprise, to (671) which I believe you did refer, didn't rise to that level. Is that true?

A. I think I said that the organization of the company grew out of and was related inextricably to the negotiation of the contracts. In other words, as the contracts were negotiated, it became evident that the means to be employed was the separate company.

The initial negotiations were conducted possibly in the name of Electric and Gas, but as far as the construction of the plant resting exclusively on any one or more of the contracts, I don't recall having expressed an opinion on it.

Q. The negotiation of the contract with the Georgia Power Company was not so related to the organization of the company that without those negotiations, Generating Company would not have been organized. Is that true?

• • •

A. I think I will have to agree that that double negative is correct, that the company would have been created, irrespective of whether Georgia took power or not.

* * *

(726) Q. Now, aside from the costs which Electric and Gas incurs in backing up the service that Generating Company renders to duPont, does Electric and Gas incur any costs in the accounting sense which are not reflected in the base charges Generating Company makes to its three customers?

A. Yes.

Q. What are those costs to Electric and Gas?

A. Well, they may be roughly divided into two categories. One is the effect of the capital structure dislocation on the parent company, and the other is the guarantees which the parent has involved itself in.

* * *

Q. Now, your first category. I didn't understand what you meant by "the effect of capital structure at this location."

A. Dislocation

* * *

(727) A. By that I meant that the 90 percent debt on the part of the subsidiary would tend to prevent the issue of debt on the parent for its new money requirements if the parent was to maintain or gradually improve the equity ratio.

Q. Yes, I understand. You testified to that in your direct testimony. Now, would you say that that is a cost which, as far as it is a cost in an accounting sense, is part of the cost of capital?

A. Part of it is cost of capital and part of it is the tax that goes with the cost of capital.

Q. The tax effect that you have just referred to would be the effect of reducing tax costs; is that right?

A. No, the tax effect would be an increase in cost to the parent company because if a high proportion of equity is issued on the parent as a corporation, a low proportion of debt, which was true during 1951 through 1954, the parent would have less interest to deduct on its tax return and would have

to pay substantially higher income taxes than it would have if it had a lower equity and a higher debt.

* * *

(728) Q. Well, then, it seems to me I may treat your tax effect as being dependent upon the same factors as relate to the cost of capital?

A. I think so.

Q. Now, as I read your testimony on this subject in your direct examination, you say that the difference between the cost of servicing the equity capital and the average cost of servicing the total capital, to the extent that that capital funds of the parent had to be provided exclusively from equity, measures such costs to Electric and Gas. That appears on page four of Exhibit 2.

I think you said roughly measures. Now, does that mean the extra cost to Electric and Gas of financing through equity capitalization, rather than through lower cost debt capital, incurred to restore the system ratio to what it was previously?

A. Yes, that would be necessary in order to restore it to what it was previously, but what actually happened was it improved slightly, so to maintain it or to restore it, as you say, or to improve it, in any event, the financing of the Generating Company would operate as a drag and involve a higher proportion of equity to be issued by the parent company.

* * *

(753) Q. And, again, the risk would be the kind of risk for (754) which it would be entitled to compensation, if at all, in the return on its investment?

A. Yes.

Q. Let me ask you whether, in that connection, this risk which is incident, as I understand your statement, to the position of Electric & Gas, as the purchaser of power under the power contract, would you say that that relates to the cost of service to Georgia Power Company for the service rendered to Georgia Power Company?

A. I think it does. Our position throughout has been that this is a system cost that we are talking about and we are not so much concerned about how much is to be found on the books of one company and how much on another and

how much of it is intangible contributions that maybe you can't put your finger on in either set of books, but rather the cost to do the job and the total cost to do the job would necessitate a return to the system and no allowance for the return to the parent is included in the base charge in the contract.

* * *

(760) A. Yes; to illustrate, if the Electric and Gas issues (761) common, preferred and debt, and assuming for the sake of argument that ten per cent return is appropriate on common, and assuming also for the sake of the argument that the composite return for both common, preferred and debt would be six per cent, there would be an additional four percent required by the parent company with respect to its own dollars; that is, with respect to dollars that are used in the general service of its customers by South Carolina Electric and Gas Company, and by the same token, the income tax which arises by reason of the dividends not being deductible, the dividends on common stock not being deductible, the taxes would be higher than they would be if you had a combination of dividends and interest, and the interest were deductible for tax purposes.

Q. Now, in your next sentence you say this amount—

A. Excuse me, may I say something further, which I think bears on that, in order not to be misunderstood?

Q. Yes, certainly.

A. The reference made here to the fact that no part of the $7.20 is to be found on the books of the Generating Company, I think is perfectly true in context. Somebody has to earn or some customer has to pay, not only for the dislocation of the capital employed by the parent company, but also for the capital, the equity funds employed by the Generating Company in the first two units.

That capital was supposed to start out at ten per cent; (762) that is, ten per cent of the capital was supposed to be equity. It is actually some $600,000 above the ten per cent figure. As the debt of the subsidiary is retired, of course, the equity proportion increases, and in connection with the spread between the revenue component for amortization of

debt and the revenue deduction item of depreciation, which you mentioned this morning, there would inevitably be not only an increase in the ratio of equity on the books of the Generating Company, but actually an increase in the dollars of equity on the Generating Company during the 25-year period, to the extent of the spread between amortization revenues and depreciation deduction; or to say it another way, to the extent of the undepreciated value of the plant at the end of 25 years, with the debt paid off in full. You can see that the undepreciated value of the plant at the end of 25 years will be entirely equity because there will be no debt.

Somebody has to earn on that equity and the eight per cent on ten per cent pays not only eight on ten, but it pays it on the $2,666,000, instead of on several millions more than that, if you assume that the three per cent depreciation is the proper rate.

* * *

(769) A. At some reasonably current date. A very large segment of that capital could not have contributed to the construction of the Urquhart station or be influenced by its construction and so I would say first of all, that we should look at the growth capital, the cost of growth capital during the period of construction to get the average (770) cost of the money dedicated to that project and in addition to that, we can't ignore the future. The likelihood is that the capital ratios will be improved. There is no good reason that I can think of why Electric and Gas in its equity ratio should continue indefinitely to lag as far behind the National average equity as it is today and has been for several years. Therefore, if we face up to the probability that the ratios will approach and will ultimately equal today's National average, you will have additional common and preferred issued in the future, in lieu of debt, there will either be the issuing of common or preferred or both, and the conservative dividend policy of the company at the present time results in some accumulation of earnings for reinvestment. The effect of this new capital is going to naturally result in the requirement for earnings to support the capital and to take care of the taxes that go with that new money and it seems perfectly

proper and equitable to require the project to bear a share of the cost of the new money in the future to the extent that the low debt of the project will act as a drag, and involve the need for additional equity in order to pull the consolidated equity up.

• • •

(872) A. The six per cent return which was used on Statement 1 was developed in consistence with our position that the cost of money and the related taxes should be looked on from the system standpoint, and therefore, in certain years, at any rate, the fifty per cent capitalization would involve the use of a tax figure in excess of the tax figure to be found on the books of the Generating Company as we look into the future.

• • •

(882) A. It is my contention that for quite a good many years the revenues produced by the billing provided under the contract including the $7.20 per KW year will not exceed the cost incurred by the South Carolina Generating Company and the South Carolina Electric and Gas Company, if we include in that cost to serve a fair rate of return on the investment and the appropriate taxes to that fair rate of return. In the early years that is quite apparent from some of the exhibits that have been filed in the case. A deficiency which occurs in the first or second or third or fourth year of the 25 year term and which the utility has to wait until the 20th or 25th year to recover represents not only a dollar deficiency in return in the early years, but a deprivation of the use of those funds for a great many years, the compound interest on which would be a very substantial figure. We feel that it would be a serious problem in view of the inadequate return in the early years to take (883) precipitate action which would aggravate that deficiency merely on some return that assumes that through the regulatory process deficient returns in early years can be recovered through regulatory benevolence in later years or by allowing returns in the later years in excess of the theoretical cost produced by the usual formula.

Exhibit 6

DIRECT TESTIMONY OF J. M. COSTELLO

Q. Please state your name, address and occupation?

A. I am J. M. Costello of Columbia, S. C.; my business address is 1309 Hampton Street in that City, and I am Executive Vice President of South Carolina Electric & Gas Company (Electric & Gas), and a Vice President of its wholly owned subsidiary, South Carolina Generating Company (Generating Company).

Q. How long have you occupied this position?

A. I have been a Vice President of Electric & Gas since 1946; I became its Executive Vice President shortly thereafter. I have been a Vice President of Generating Company since shortly after its organization in 1951.

Q. Have you occupied other positions in the public utility industry?

A. Yes, I have. I have for many, many years been connected with this industry, and have served in a variety of positions with several ~~different~~ utilities.

Q. In addition to the duties normally attendant upon the office of Executive Vice President of Electric & Gas, do you exercise any other duties of a particular nature of especial interest here?

A. Yes. Before becoming Executive Vice President of Electric & Gas I was its Financial Vice President. The duties of this office entailed those normally exercised by the chief financial officer of a corporation. In this position particular emphasis was laid upon securing new funds with which to finance additions, betterments, and similar items normally attendant upon a rapidly expanding electric utility. These monies were secured chiefly through the issuance and sale of common and preferred stock and bonds. These duties I still exercise as a function of my office of Executive Vice President.

Q. Explain the basis on which Generating Company was financed.

A. This financing has followed generally the pattern pursued by Electric Energy, Inc., in securing funds with which to finance the construction of its steam electric generating

station near Paducah, Kentucky. This plant was built to supply electric capacity and energy to an installation of the United States Atomic Energy Commission (AEC) near that point.

Q. Why was this pattern followed?

A. It was particularly fitting that this method should be used here. As another witness, F. R. McMeekin, will more fully testify, AEC, acting through its prime contractor at its Savannah River Plant (SRP), E. I. duPont de Nemours and Co., approached Electric & Gas about securing power for use at the SRP. It became obvious that normal financing would not produce a plant which could sell power at a price which would sell to AEC. It was but a normal and logical step to resolve this problem in approximately the same manner it had already been worked out for AEC by Electric Energy, Inc.

Q. Why was a separate corporation formed?

A. Quite obviously Electric & Gas because of its Indenture retsrictions could not finance such a plant on the basis contemplated. Hence the formation of a separate corporation was necessary.

Q. What type of securities were used, and in what ratio, to secure the capital for the plant here in question?

A. 75% of these were mortgage bonds, 15% were ten year notes and the remaining 10% was in the form of common stock.

Q. Tell us whether or not you discussed this financing with the Securities and Exchange Commission (SEC)?

A. Yes, I did discuss the proposed issuance of securities with the staff of SEC, although no formal action was required by that Commission. The staff informed us that they would expect Electric & Gas' subsequent financing to be of a character such as would tend to reduce the impact of this high debt ratio on its capital structure.

Q. Answer whether or not Georgia Power Company (Georgia Power) indicated any interest in securing power from this new plant?

A. Indeed they did. Their representatives approached us and expressed a keen interest in securing power from this new plant—which was ultimately named Plant Urquhart—and exhibited a desire to participate in the venture.

Q. State whether or not you participated in the negotiation of the contract which resulted from this approach by Georgia Power.

A. I did.

Q. Describe these transactions.

A. These negotiations consisted of lengthy sessions spread over several months. Both sides were represented by a committee of engineers, financial men, accountants, lawyers, tax specialists, and such other personnel as might be necessitated by the problem of the moment. All problems were openly, fully, and thoroughly discussed and completely and freely negotiated upon. Frankly, I have never seen any negotiations conducted more at arm's length than these were. All during these sessions it became increasingly evident how much Georgia Power would benefit from this type of financing.

Q. Does this contract have a recapture clause or not?

A. Yes, it does.

Q. Please describe it.

A. Section 4.03 of the agreement provides for the recapture, at will, by Generating Company of not over 25,000 KW upon twelve months notice. Section 4.04 provides that all of the contract demand not already taken under Section 4.03 may be recaptured upon thirty months notice.

Q. Tell us what factors might impel Generating Company to exercise its right of recapture.

A. Barring some unforseen eventuality which would make it unfeasible for Generating Company to secure equipment in the open market or to construct new plants, such factors would, of course, be chiefly economic ones.

Q. Please enlarge on this.

A. In a system which is expanding as rapidly as ours the cost of new plants is an ever present and saliently impelling factor. When Plant Urquhart was originally constructed, only two units were ordered—each of 75,000 KW capacity. Before these were completed, a 100,000 KW unit was ordered. The first two units were completed last year (1954), and work is already well in progress on the installation of this third unit. Already plans are being formulated for the construction of still another plant to support the ever-increasing load of the system. Quite naturally this requires us to e-

sess at short intervals the cost of constructing these new plants against the return we derive from the capacity at Urquhart used by Georgia Power. When this latter amount reaches a point below the former, in the absence of some other impelling motive of which I am not currently aware, recapture will follow as a rational and normal result. And I will also say that increased costs evidenced in just the few years since this contract was executed have brought these two factors already dangerously close together.

CROSS-EXAMINATION OF MR. J. M. COSTELLO

By Mr. Wahrenbrock:

(915) Now, when did the device of a separate corporation enter into your plans?

A. Mr. Wahrenbrock, we made considerable studies at (916) the time when duPont project, or the hydrogen project was to be publicly stated to be located in South Carolina.

• • •

(916) We reviewed—or I reviewed—various programs of the possibility of financing this huge power plant, and we had considered seriously the possibility of doing it within the confines of the corporate limits of South Carolina Electric and Gas Company.

We recognized the limitations that would be imposed by using the corporate structure of South Carolina Electric and Gas Company because of the existing indenture provided for a limitation of 60 percent take-down of bonds.

• • •

Primarily because of that situation was the reason that South Carolina Generating Company was formed. In fact, If I might say at this point, that the only reason that the South Carolina Generating Company, or a subsidiary company, was formed, was because of the limitation or the restrictions imposed.

• • •

A. I would say it was the prime reason. I don't recal at the moment whether there were any other reasons, but know that the prime reason was the restriction imposed o

the indenture of South Carolina Electric and Gas Company prohibiting the issuance of bonds beyond 60 percent.

(917) So it was necessary to form a separate corporation in order to do this type of financing, recognizing full well that as far as the prospective institutions that would invest in these securities, that they would require sufficient guarantees on the part of the parent to assure that the credit of South Carolina Electric and Gas Company were back of these issues, and it wasn't relying solely on the credit or the standing of South Carolina Generating Company which was just created solely for that purpose.–

• • •

(929) Q. I don't understand, Mr. Costello, why this lower cost of financing, which is produced, which you expected to be produced, by the 90-percent debt ratio method of financing, in lieu of the conventional method of financing, is not regarded by you as a reduction of the cost of doing business.

A. I don't mean to imply that it is not a reduction in the cost of doing business in the sense that what chiefly developed by the utilization of a 90-percent debt as contrasted with the conventional 50- or 60-percent was the fact that we gained momentarily a tax advantage, that we recognize that subsequently we had to correct our capital (930) structure which necessarily meant that we had to sell more equity securities in subsequent years to correct for that situation that was produced as a result of the impact of that high debt.

We felt that the earnings that would develop from the contracts in force would enable us to make those correcting factors over a reasonable period of time.

That in the interim period, South Carolina Electric and Gas Company and the public which it was serving would have the advantage of having that huge system plant available to provide for the service and growth in our service territory.

Q. Was it your view that the 90-percent debt ratio method of financing, the use of a 90-percent debt ratio financing in lieu of a convention method of financing, would only postpone costs of doing business?

A. I did not want to confine my answer solely to that situation whatsoever. I said that one of the prime things that influenced us to take the 90-percent debt basis was that that was the only means that we could forsee that would safely permit us to develop this huge project representing $25 million in producing a power plant of 100,000 kilowatt capacity; that resorting to conventional-type financing at the time, as I recall the financial condition of the company, we did not see how we could resort to a conventional-method (931) of financing at that time to produce the plant of that capacity. That was one of the reasons that motivated us in taking and resorting to that type of financing.

Now, the secondary reason was that we realized full well that that was going to create an impact on the financial structure of South Carolina Electric and Gas Company and the equity at that time would be reduced substantially. But we realized, we felt, that the earnings that would be generated from these contracts, plus the growth in the territory because of the hydrogen plant, the combination of which would produce earnings that would enable us to sell equity securities to restore the equity position of the company to what we felt was a proper one.

The actual facts in the case are that during the period of construction, we actually sold the equity securities on the plant. As I recall, the testimony in this case shows that in producing the outside money requirements from 1951 to 1954, that some 70 percent was raised through equity money, and that bears out my contention.

* * *

(937) MR. WAHRENBROCK: I will try to make that as plain as possible, because as I regard this testimony, the witness started out with the problem he was employed by Electric and Gas, and Electric and Gas wanted to get this business, and adopted a special method of financing which included a separate corporation.

Now, for the purpose of this question, I think it is proper to regard what was done through a separate corporation as a device that was used by Electric and Gas.

Now, if we want to argue that separately, all right, but I would like to assume that for the purpose of this question.

• • •

(938) THE WITNESS: Mr. Wahrenbrock, my answers were intended to indicate that temporarily, not in the long run, that the impact of this high debt ratio would require South Carolina Electric and Gas Company to issue a greater amount of equity securities than it normally would in order to correct for that impact.

But once that was accomplished, the cost of money in the long run, as you say, would not be in excess of the conventional method of financing or the ordinary type of method as usually resorted to by a utility.

• • •

(948) PRESIDING EXAMINER: I want to go back to this business of potentiality and the possibility of normal financing to do this job. I want to be sure that I understand you on two points, because, to my mind, they are fairly critical facts.

The first is—and I want to ask this broader, and I am not going to state it the way you do; I am going to state it a little differently: Was there any method by which—any method that you knew of then, or could discover then, or even know of now—the parent company—and there wasn't a subsidiary then; there was just one company—could have financed this power (949) plant at costs low enough to attract the duPont business?

THE WITNESS: There were none. In fact, there was considerable doubt in my mind, and at the time I didn't know of any other way that we could successfully finance even at any other cost. I mean it seemed to me that there was no other feasible way.

PRESIDING EXAMINER: All right. This, then, was a tactic of necessity? You either got the duPont business by this method or you did not get it at all?

THE WITNESS: That is unquestionably true.

PRESIDING EXAMINER: That nails that fact down.

Now, the second point is this—and this is an implication; but I am trying to get it clear so I will not have to base my

appraisal later on implication solely; but it may be clearer than I think; and I am using my memory; I have not read this.

Having in mind the financial condition of the parent company, which, again, was the only company at the time, as the financial adviser, as the officer charged with raising money through securities, and knowing that financial condition, could you, regardless now of the costs resulting, successfully have financed this amount of money?

THE WITNESS: I did not believe so.

PRESIDING EXAMINER: So, it also became, from that angle, a tactic of necessity to use the subsidiary and the special 90 percent, or whatever it was, type of debt ratio financing?

(950) THE WITNESS: That was the conclusion I had reached and which I so recommended.

* * *

(972) Q. Did the nature of the Savannah River project and the relationship of the Urquhart plant to that project give rise to any difficulty in interesting Metropolitan Life in financing this plant?

A. It did, and that was one of the reasons that Metropolitan was very anxious that South Carolina Electric and Gas Company in every way would guarantee the situation in such a manner as if they were directly obligated in the first instance.

So that these insurance companies would not be dependent solely on falling back on the power plant as a source of security; that their protection would lie in the credit of South Carolina Electric and Gas Company. They well recognized (973) that South Carolina Generating Company was merely created as a vehicle to permit the financing; that it had no credit standing of its own.

Q. Did you feel that that was a factor making it difficult for you to get as cheap money as you might otherwise have gotten?

A. No. I would say this: That with the willingness on our part that South Carolina Electric and Gas would back

up this situation, that it contributed to a lower cost of money than otherwise could have been obtained.

• • •

(976) Q. Now, you spoke of Metropolitan Life's interest in the contracts for the sale of the power in connection with the financing.

What effect did the negotiations or the prospect of a negotiation of a contract with Georgia Power Company have on the negotiations with Metropolitan Life?

A. Well, when Georgia Power Company had indicated to us an interest in participating in this situation, I approached Metropolitan, as well as the other institutions, with the suggestion that we had, that we wanted to amend our original proposal so as to permit Georgia Power Company to participate.

The program as then more or less finalized was with the understanding that South Carolina Electric and Gas Company would agree that in the event that Georgia Power Company, for any reason whatsoever, would terminate the contract, that the obligation would fall on South Carolina Electric and Gas Company so that it would conform with the initial undertaking.

Furthermore, it was provided in the negotiations at (977) that time, and subsequently incorporated in the contract, that if duPont would increase their requirement from 30,000 up to 63,000, as they were then contemplating—I mean, they had a high and a low figure at that point; whether it was 30,000 or 63,000—we had provided a slot in our financing whereby we could recapture from Georgia sufficient of that capacity so that we could place it back on duPont if conditions would require.

The insurance companies were very much interested in seeing that that was provided, because it would fall back then, more or less somewhat in substance, with the original agreement.

STATEMENT OF THE CHAIRMAN OF THE PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA

My name is Clyde F. Boland, and I am Chairman of the South Carolina Public Service Commission ("Commission").

Our Commission has regulated—and has been thoroughly familiar with the operation of—the South Carolina Electric & Gas Company; parent of the Respondent, South Carolina Generating Company, and its predecessor corporation for many years. This has been particularly true since the passage by the South Carolina General Assembly of the Public Utility Regulatory Act of 1932.

Our Commission has been kept thoroughly appraised of the plans of South Carolina Generating Company since its inception, including the contract here under consideration. We were kept thoroughly appraised of the progress of the negotiation of this contract, and of all the circumstances surrounding it. These plans were approved by our Commission, as was also true of this contract, as well as all other contracts of South Carolina Generating Company. We feel that these contracts are good contracts. We feel that the rates paid by the consumers are in all cases fair and reasonable. The contract here under consideration—as well as the rates therein—are quite obviously fair and reasonable, and represent, in our opinion, a good agreement for the affected consumers in both South Carolina and Georgia. We are at a loss to understand the reasons for this hearing.

The Federal Power Commission has stated that there is some indication that the rate in the Georgia contract is discriminatory in view of the rate in the contract between Electric & Gas and Generating Company. To begin with, we do not feel that the Federal Power Commission should compare these two contracts. It has no jurisdiction over the contract between Generating Company and Electric & Gas, that being solely within the province of the South Carolina Public Service Commission. If the Federal Power Commission should find that the Georgia contract presents a reasonable rate, but that the Electric & Gas contract is even lower than a reasonable price we fail to see how that would effect the reasonableness of the Georgia contract. However, our Commission has looked at both contracts, and do not find them to be the least bit discriminatory. Electric & Gas has performed many services for Generating Company, made many commitments for it, entered into certain guarantees for it, and has experienced a substantial impact on its own capital structure with a resultant additional burden imposed upon its own financ-

ing. We feel that the cost of these to Electric & Gas, and the value of them to Generating Company, make up for any differential enjoyed by Electric & Gas in its purchases over the price paid by Georgia Power Company in its purchases.

Further, we feel that the rate enjoyed by Georgia Power Company is reasonable. We do not believe that during the life of the contract Georgia will pay an unreasonable rate for its power. Even if we assume that at some date in the future the rate of return may be excessive, we do not feel that the Federal Power Commission should act to lower this rate until that point is reached. It is perfectly obvious that any projections as to future rates of return must be based upon assumptions, and these may never become realities. Even if we assume that at some future date the rate of return may be excessive, who knows what events may interpose themselves between the present and that future date to the extent that service may not even be rendered under the contract at that time. Hence, we strongly urge that even if a finding should result—and we do not feel that it will—that at some future date the rate of return may be excessive, that the Federal Power Commission wait until such future date to take any action in regard to the rate.

From the testimony of Respondent's witnesses it is obvious that Georgia Power Company is getting its power for considerably less than they could have gotten it by any other available means. This should be applauded as a sensible, farsighted business arrangement redounding to the interest of rate payers in both Georgia and South Carolina; not something that should be vilified.

If the contract were voided, the Georgia Power Company would have to build a new plant and power from the new plant would cost Georgia Power Company considerably more which additional cost would be passed on to the Georgia consumers thereby costing them more for service.

It seems to our Commission that any revision of these rates downward would be loading on consumers in South Carolina an unfair share of the cost in this instance. We see no warrant for such a move.

I have conferred with the Governor of South Carolina and he is of the opinion that the present contract is just and reasonable and that no change is warranted.

Exhibit Attached to Statement of Clyde F. Boland

STATE OF SOUTH CAROLINA
THE PUBLIC SERVICE COMMISSION

Columbia 1, S. C., Jan. 2, 1952.

State of South Carolina
County of Richland

Before the Public Service Commission

In Re: Application of the South Carolina Electric & Gas Company for Authority (1) to Form a Subsidiary Company (2) for the Said Subsidiary Company to Construct Facilities, and (3) for the Necessary Financing in Connection Therewith.

Order No. E-671

Docket No. 7719

To: South Carolina Electric & Gas Company, Columbia, South Carolina and South Carolina Generating Company, Columbia, South Carolina

WHEREAS, this Commission issued its Orders Nos. E-668 and E-671 on October 5, 1951 and November 20, 1951, respectively, authorizing South Carolina Electric & Gas Company, hereinafter sometimes referred to as the "Company", and South Carolina Generating Company, hereinafter sometimes referred to as the "Generating Company";

(a) As to the Generating Company:

(1) To enter into Power Contracts with the Georgia Power Company and the South Carolina Electric & Gas Company substantially similar in form and content to those attached to the Supplemental Petition of the Company and Generating Company dated October 4, 1951, as Exhibits D and E thereto, respectively; and

(2) To issue and sell to Metropolitan Life Insurance Company of New York in accordance with the terms and conditions of a Bond Purchase Agreement and an Indenture submitted with the aforesaid Supplemental Petition of October 4, 1951, as Exhibits A and C, respectively, the final terms and conditions of which were to be furnished the Commission by a petition supplemental thereto and final approval for which was to be

given by an order supplemental thereto, not to exceed $16,800,000 principal amount of First Mortgage Bonds, maturing not later than 28 years from the date of the aforesaid Bond Purchase Agreement, bearing interest at the rate of 3⅞ per centum per annum, the sale price to be 100% of the principal amount thereof; and

(3) To issue and sell to Northwestern Mutual Life Insurance Company, Milwaukee, Wisconsin, in accordance with the terms and conditions of a Bond Purchase Agreement and an Indenture submitted with the aforesaid Supplemental Petition of October 4, 1951 as Exhibits A-1 and C, respectively, the final terms and conditions of which were to be furnished the Commission by a petition supplemental thereto and final approval for which was to be given by an order supplemental thereto, not to exceed $3,200,000 principal amount of First Mortgage Bonds maturing not later than 28 years from the date of said Bond Purchase Agreement, bearing interest at the rate of 3⅞ per centum per annum, the sale price to be 100% of the principal amount thereof; and

(4) To issue and sell to Mellon National Bank and Trust Company, of Pittsburgh, Pa., as Trustee of sundry Trust Estates, in accordance with the terms and conditions of a Note Purchase Agreement submitted with the aforesaid Supplemental Petition of October 4, 1951, as Exhibit B, the final terms and conditions of which were to be furnished the Commission by a petition supplemental thereto, and final approval of which was to be given by an order supplemental thereto, $3,000,000 principal amount of its Promissory Notes, maturing October 1, 1961 and bearing interest not in excess of 4 per centum per annum at a sale price of 100% of the principal amount thereof; and

(5) To issue and sell to Reliance Life Insurance Company of Pittsburgh, Pa., in accordance with the terms and conditions of a Note Purchase Agreement submitted with the aforesaid Supplemental Petition of October 4, 1951 as Exhibit B, the final terms and conditions of which were to be furnished the Commission by a petition supplemental thereto and final approval for which

was to be given by an order supplemental thereto, $1,000,000 principal amount of its Promissory Notes, maturing October 1, 1964 and bearing interest not in excess of 4 per centum per annum at a sale price of 100% of the principal amount thereof; and

(6) To issue and sell shares of Capital Stock of said Generating Company for an aggregate consideration not in excess of $2,666,666.67 and to receive any contributions to its capital which may be made; and

(7) To enter into, execute and deliver, and to perform and carry out, all of the terms and conditions of the Bond Purchase Agreements, Note Purchase Agreements and the Indenture, the final terms and conditions of which were to be furnished the Commission by a petition supplemental thereto, and final approval for which was to be given by an order supplemental thereto, all substantially in the forms of Exhibits A, A-1, B and C, respectively to the aforesaid Supplemental Petition of October 4, 1951;

(b) As to the Company:

(1) To purchase for not to exceed $2,666,666.67, shares of Capital Stock of the Generating Company, the issuance of which was authorized by paragraph (a) (6) above, and to enter into, execute and deliver, and to perform and carry out all of the terms and conditions of the Bond Purchase Agreements, Note Purchase Agreements and the Power Contract with the Generating Company, including the making of any contributions to the capital of said Generating Company contemplated therein, all substantially in the forms of Exhibits A, A-1, B and E, respectively, to the aforesaid Supplemental Petition of October 4, 1951.

WHEREAS, the Company and Generating Company have filed a Supplemental Petition dated December 27, 1951, stating that they have completed the drafting of and have entered into, executed and delivered

(a) Bond Purchase Agreements with Metropolitan Life Insurance Company and Northwestern Mutual Life Insurance Company, respectively, in the forms submitted with said Supplemental Petition of December 27, 1951, and made a

part thereof as Exhibits A and A-1, providing for the sale to said institutions, respectively, of not in excess of $16,800,000 and $3,200,000 principal amount of First Mortgage Bonds, 3⅞% Series due 1979 of Generating Company at a price of 100% of the principal amount thereof; and

(b) Note Purchase Agreements with Mellon National Bank and Trust Company, as Trustee of sundry Trust Estates, and Reliance Life Insurance Company of Pittsburgh, respectively, in the forms submitted with said Supplemental Petition of December 27, 1951 and made a part thereof as Exhibit B and B-1, providing for the sale to said institutions, respectively, of not in excess of $3,000,000 and $1,000,000 principal amount of 4% Promissory Notes due 1964 of Generating Company at a price of 100% of the principal amount thereof; and

(c) A Power Contract between themselves and The First National Bank of South Carolina of Columbia in the form submitted with said Supplemental Petition of December 27, 1951, and made a part thereof as Exhibit E; and

WHEREAS, said Supplemental Petition of December 27, 1951, also states that Generating Company has entered into, executed and delivered a Power Contract between itself, Georgia Power Company and The First National Bank of South Carolina of Columbia in the form submitted therewith and made a part thereof as Exhibit D, and

WHEREAS, said Supplemental Petition of December 27, 1951, also states that the drafting of the Bond Indenture, to secure the First Mortgage Bonds, 3⅞% Series due 1979 of the Generating Company, has been substantially completed and the Generating Company plans to execute the Bond Indenture in substantially the form submitted with said Supplemental Petition of December 27, 1951, and made a part thereof as Exhibit C; and

WHEREAS, said Supplemental Petition of December 27, 1951, also states that the Construction Agreement between Generating Company and Gilbert Associates, Inc. in the form submitted with said Supplemental Petition of December 27, 1951 and made a part thereof as Exhibit F has reached final form and the Generating Company plans to execute the Construction Agreement in substantially such form; and

NOW, THEREFORE, having carefully considered the Supplemental Petition dated December 27, 1951 and Exhibits thereto and all relevant facts, this Commission is of the opinion and so finds, that:

(1) The proposed financing program, as set forth in Supplemental Petition dated December 27, 1951, together with Exhibits A, A-1, B, B-1 and C to said Supplemental Petition and the funds expected to be obtained thereby are necessary and proper for the purposes for which they are to be used and the securities planned to be issued are of the kind and type most advantageous for the purposes involved; and

(2) The Power Contracts in the forms set forth as Exhibits D and E to the Supplemental Petition dated December 27, 1951, and the Construction Agreement in substantially the form set forth as Exhibit F to said Supplemental Petition dated December 27, 1951, are or will be of the kind and type most advantageous for the purposes intended, to wit, to provide for the construction of the steam electric generating plant at Beech Island, South Carolina and the sale of power generated thereat.

WHEREFORE, in consideration of the foregoing, IT IS ORDERED, ADJUDGED AND DECREED that

(1) The actions of the Company and Generating Company in entering into, executing and delivering the Bond Purchase Agreements and the Note Purchase Agreements in the form of the four instruments submitted with and made a part of the Supplemental Petition dated December 27, 1951, as Exhibits A, A-1, B and B-1, respectively, are ratified and approved.

(2) The Company and Generating Company are granted authority to perform and carry out all of the terms and conditions of the Bond Purchase Agreements and Note Purchase Agreements as set forth in the four instruments submitted with and made a part of the Supplemental Petition dated December 27, 1951, as Exhibits A, A-1, B and B-1.

(3) The Generating Company is granted authority to issue and sell not in excess of $20,000,000 principal amount of its First Mortgage Bonds 3⅞% Series due 1979 in accordance with the terms and conditions set forth in the Bond

Purchase Agreements submitted with and made a part of the Supplemental Petition dated December 27, 1951, as Exhibits A and A-1, respectively, and to issue and sell not in excess of $4,000,000 principal amount of its 4% Promissory Notes due 1964 in accordance with the terms and conditions set forth in the Note Purchase Agreements submitted with and made a part of the Supplemental Petition dated December 27, 1951, as Exhibits B and B-1, respectively.

(4) The Generating Company is granted authority to issue and sell to the Company shares of its Capital Stock for an aggregate consideration which together with contributions to its capital heretofore made shall not exceed $2,666,666.67 and to receive from the Company any further contributions to its capital which may be made, all in accordance with the terms and conditions of, and as contemplated by, the aforesaid Bond Purchase Agreements and Note Purchase Agreements.

(5) The Company is granted authority to purchase shares of the Capital Stock of the Generating Company for an aggregate consideration which together with contributions to the capital of the Generating Company heretofore made shall not exceed $2,666,666.67 and to make any further contributions to the capital of Generating Company, all in accordance with the terms and conditions of and as contemplated by, the aforesaid Bond Purchase Agreements and Note Purchase Agreements.

(6) The action of the Generating Company in entering into, executing and delivering the Power Contract with Georgia Power Company and the First National Bank of South Carolina of Columbia in the form of the instrument submitted with and made a part of the Supplemental Petition dated December 27, 1951, as Exhibit D are ratified and approved.

(7) The Generating Company is granted authority to perform and carry out all of the terms and conditions of the Power Contract referred to in Paragraph 6 above.

(8) The actions of the Company and the Generating Company in entering into, executing and delivering the Power Contract between themselves and the First National Bank

of South Carolina of Columbia in the form of the instrument submitted with and made a part of the Supplemental Petition dated December 27, 1951, as Exhibit E are ratified and approved.

(9) The Company and the Generating Company are granted authority to perform and carry out all of the terms and conditions of the Power Contract referred to in Paragraph 8 above.

(10) The Generating Company is granted authority to enter into, execute and deliver and to perform and carry out all of the terms and conditions of the Bond Indenture in substantially the form submitted with and made a part of the Supplemental Petition dated December 27, 1951, as Exhibit C.

(11) The Generating Company is granted authority to enter into, execute and deliver and to perform and carry out all of the terms and conditions of the Construction Agreement in substantially the form submitted with and made a part of the Supplemental Petition dated December 27, 1951, as Exhibit F, and

(12) The Company and Generating Company are granted authority to do any and all other things necessary and incidental to the transactions herein referred to.

All previous orders of the Commission in this Docket No. 7719, except insofar as the provisions of any of them may be modified or changed by this order, shall remain in full force and effect; any provisions of such previous orders, or any of them, if any, which are in conflict with any of the provisions of this order, are hereby superseded by the provisions of this order.

BY ORDER OF THE COMMISSION.

/s/ J. C. DARBY, *Chairman*

ATTEST:

/s/ J. N. LAND, JR., *Secretary*

TESTIMONY SUBMITTED BY THE STAFF OF THE FEDERAL POWER COMMISSION

Exhibit 19

DIRECT TESTIMONY OF DALE E. GOUBLEMAN

Introduce rate of return study exhibit.

Q. Will you state your name?

A. My name is Dale E. Goubleman.

Q. What is your position at the present time?

A. I am a Public Utilities Specialist, Office of Chief Accountant, Federal Power Commission.

Q. Will you state your educational background?

A. I was graduated from the School of Business Administration of the University of Nebraska in June 1932 with a degree of Bachelor of Science.

Q. Will you state your experience?

A. From January 1934 to March 1937 I was employed as an Auditor and Cost Accountant with the Corps of Engineers, U. S. Army. From March 1937 to May 1939 I was an Examiner of Accounts with the Federal Power Commission. From May 1939 to November 1945 I was employed as a Special Agent with the U. S. Department of Justice; since November 1945 I have been with the Federal Power Commission. My duties with the Commission include the examination of the testimony and exhibits in gas certificate cases, insofar as such testimony and exhibits relate to the proposed financing of the projects to be constructed under the certificate proceedings, for the purpose of assisting staff counsel in the preparation of cross-examination, and to prepare recommendations thereon for the Commission as to the financial feasibility of proposed projects.

I also direct research in connection with the subject of fair rate of return for electric and natural gas utilities. I have testified as a Commission staff witness before the Federal Power Commission on the subject of rate of return in the following proceedings;

(a) In the Matter of

City of Pittsburgh vs. Pittsburgh and West Virginia Gas Company, Docket G-635.

(b) Otter Tail Power Company, Docket IT-6916.
(c) Pennsylvania Water and Power Company, Docket IT-5915.
(d) Ohio Fuel Gas Company, Docket G-1268.
(e) Hope Natural Gas Company, Docket G-1292.
(f) Northern Natural Gas Company, Dockets G-1382, G-1533, G-1607.
(g) Atlantic Seaboard Corporation, Docket G-1384.
(h) Mississippi River Fuel Corporation, Docket G-1641.
(i) Colorado Interstate Gas Company, Docket G-1115.
(j) Panhandle Eastern Pipe Line Company, Docket G-1116.
(k) Natural Gas Pipeline Company of America, Docket G-1697.
(l) Michigan-Wisconsin Pipe Line Company, Docket G-1678.
(m) El Paso Natural Gas Company, Docket G-2018.
(n) Hope Natural Gas Company, Docket G-2303.
(o) United Gas Pipe Line Company, Docket G-1142, et al.

I have twice appeared before the Utah Public Service Commission as a staff witness for that Commission, the first time in June 1947, Re: Mountain Fuel Supply Company, and in June 1949 Re: Utah Power & Light Company. In July 1949 I appeared before the Public Service Commission of the State of Vermont as a witness for the staff of that Commission in the matter of Central Vermont Public Service Corporation, and in May 1950, I again appeared before the Commission as a rate of return witness in the matter of Newport Electric Division of Citizens Utilities Company.

Q. Mr. Goubleman, have you prepared a rate of return study for use in this proceeding?

A. Yes, sir, I have prepared such a study.

Q. I direct your attention to Exhibit No. 18. Is this the exhibit to which you have just referred?

A. Yes, it is.

Q. Will you state generally the sources from which you have obtained the data and information contained in that exhibit?

A. Moody's Public Utilities Manuals, Cumulative Index and Bond Survey, Securities & Exchange publications, Standard & Poor's Stock Guide and Bond Guide, Standard and

Poor's Standard Corporation Descriptions, Bank and Quotation Record published by William B. Dana Company, New York, Federal Reserve Bulletins, FPC Forms No. 1, company reports to stockholders, and company's prospectus.

Q. What principles were followed by you in the preparation of Exhibit No. 18.

A. I followed the principles laid down in *Power Commission v. Hope Natural Gas Company,* 320 U. S. 591, which reads as follows:

> "From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. Cf. *Chicago & Grand Trunk Ry. Co. v. Wellman,* 143 U. S. 399, 345-346. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital. See *Missouri ex rel. Southwestern Bell Tel. Co. v. Public Service Commission,* 262 U. S. 276, 291 (Mr. Justice Brandeis concurring)."

Q. What is the purpose of the exhibit?

A. The purpose of this exhibit is to furnish the Commission with comprehensive pertinent financial data on which it can rely in the exercise of judgment as to the fair and reasonable rate of return for South Carolina Generating Company.

Q. Mr. Goubleman, without attempting to restate the data or information set forth in the exhibit, will you briefly explain Exhibit No. 18?

A. The first section of the exhibit, comprising pages 1 through 6b, sets forth data by months showing the average interest rates on outstanding bonds of the U. S. government, industrials, railroads, and utilities, for the period January 1920 to the present time.

The yields on the outstanding U. S. Treasury Bonds, pages 1a through 1c were compiled by the U. S. Treasury Department and published in the monthly Federal Reserve Bulletins. The chart on page 1 was prepared from this data by

the staff of the FPC under my direction and supervision. Yields on the industrial, railroad and utility bonds included on pages 2a through 6b were compiled and published by Moody's Investment Services. The charts on pages 2 and 3 were based on the data shown on the lettered sheets following the charts. Such charts were prepared by the FPC staff under my direction and supervision. All of the yields included in pages 1 through 6b are based on day-to-day market transactions of outstanding securities as differentiated from newly issued securities.

Page 7 and lettered pages which follow set forth by ratings data relative to the cost of all bonds issued by electric operating utilities to the public by years since 1945 as reported by Moody's Services. For the years 1946 through 1954 the data is summarized by years and ratings and the supporting data are set forth in Appendix A. The available data for the year 1955 appear on pages 7b and 7c. On pages 7d-7e are shown the cost of issuing bonds according to size of issue.

On page 8 and the lettered pages which follow are set forth similar information with reference to all issues of preferred stocks to the public by all electric operating utilities since 1945, as reported by Moody's Services. The data are summarized by years for the period 1946 through 1954 and the supporting detail appears in Appendix B. Page 8a sets forth the yields to the public and cost to the company of electric preferred issues sold during the year 1955 insofar as such data are available.

On page 9 and lettered pages which follow are listed all the issues of common stock sold in their entirety to the public by all electric operating utilities for the period 1946 to date, as shown in Moody's Services. Included therein for each issue are the earnings offering price ratio, yield to purchaser, payout at time of offering, and the *capital ratios of the company prior to the offering.*

Page 10 and lettered pages which follow set forth the earnings-price ratios and yields on the common stocks of groups of electric utilities by months since January, 1940. It will be noted that the series which originally comprised ten electric operating utilities has been gradually expanded so that commencing with 1950, 25 utilities comprise the series. The revenues of those utilities are derived chiefly from electric oper-

ations. These utilities were selected to include companies of various sizes and to represent the various sections of the entire nation. The list has been confined to companies, the common stock of which is in the hands of the public, is traded on a recognized exchange with quotations available almost daily, and whose dividends have been paid for a number of years. The identities of the companies are set forth on page 10c. Page 10d sets forth the earnings-price ratio and yield on the common stock of each company for February, 1955, together with the composite earnings-price ratio of the group for February, 1955, which is shown on page 10b. The earnings price ratios and yields for each month, commencing with 1940 as shown on pages 10 through 10b were computed in the same manner as that for February, 1955, as shown on page 10d. Page 10e is a summary of the earnings-price ratios, yields, payouts of the 25 companies for the month of February, 1955, together with the capital ratios of these companies at December 3, 1953, the latest date for which complete data are available. Page 10f sets forth the composite yields on the outstanding preferred stocks of the same groups of utilities by months since January, 1940. On page 10g are shown the detail supporting the yield shown on page 10f for February, 1955. Each of the yields on page 10f was developed in the same manner as shown on page 10g. Page 10h sets forth the earnings-price ratios by months since January, 1950, of those electric utilities which have annual operating revenues ranging from 25,000,000 to 50,000,000, and whose common stocks are traded on an exchange. The annual revenues of South Carolina Electric & Gas Company during the past three years have fallen within this range.

Pages 11 through 15 set forth data relating exclusively to South Carolina Electric & Gas Company, parent of South Carolina Generating Company. Inasmuch as all of the debt of the Generating Company is held privately and all of the stock is owned by Electric & Gas, market quotations on the securities of the Generating Company are not available.

In view of the foregoing it was deemed appropriate to set forth financial data relating to Electric & Gas inasmuch as investors in the debt securities of the Generating Company would look beyond that company to the over-all financial set-up of Electric & Gas Company. Likewise, investors in the

securities of Electric & Gas Company would be interested not only in the parent company but also its subsidiaries and the system as a whole.

Page 11 sets forth the capitalization and capital ratios of Electric & Gas system as of December 31, 1954. At that time debt comprised 62.8%, preferred stock 9.4%, and common stock and surplus 27.8% of the total capitalization. Reference is made to page 10c which sets forth the composite capital ratios of the 25 companies at December 31, 1953, the latest data for which information is available. It will be noted that with reference to the 25 companies debt comprised approximately 50%, preferred stock 12%, and common equity about 38% of the total capitalization.

Page 12 shows the cost of the outstanding debt of Electric & Gas system as 3.46%, and preferred stock as 4.9%.

Pages 13 and 14 set forth the earnings-price ratios and yields on the common stock of Electric & Gas by months since January, 1950. Comparison of these figures with those for the 25 companies appearing on pages 10 through 10b shows that while the figures for Electric & Gas have been somewhat higher in earlier years, the spread between those for Electric and Gas and those for the 25 companies has narrowed considerably. For example, the average yield on the common stock of Electric & Gas for 1954 was 4.7%, which is 1/10 of one percent less than the 4.8% for the 25 companies. The earnings-price ratios for 1954 average 7.2% as against 6.3% for the 25 companies. This difference, no doubt, can be accounted for in great part by the relatively smaller size of Electric & Gas, the relative thinness of its common equity, its lower payout of earnings. On the average, the 25 utilities have been paying out during the past few years in excess of 70%, whereas Electric & Gas, as shown by page 16 of the Exhibit, has paid out from 58% to 67% of its available earnings. Likewise, comparison of the figures on pages 10b and 14 show that the common stock of Electric & Gas has been selling on as favorable a basis as the common stocks of the companies which are comparable in size to Electric & Gas.

Page 15 shows the offerings of common stock by Electric & Gas since 1947. All of these issues have been offered to the then common stockholders under preemptive rights at prices less than the prevailing market price of the stock.

Since 1949 these offerings have been made on an offering-price ratio and net offering-price ratio of less than 8.2%. Since the issue of 1949 all offerings have been made at prices approximately equal to or substantially in excess of the book value of the common stock.

Page 16 shows the per share earnings dividends and range of market prices of the Electric & Gas common stock for the years 1950 through 1954. It will be noted that since 1951 the average market price of the common stock has exceeded the book value and, in 1954, the average market price was in excess of 160% of the book value.

Exhibit 44

TESTIMONY OF KENNETH L. SMITH

My name is Kenneth L. Smith. I am employed by the Federal Power Commission as Supervisory Auditor, and reside in Bethesda, Maryland. I obtained my formal education in accounting, finance and business at the College of Commerce and Business Administration of the University of Illinois, receiving a Bachelor's Degree in 1927 and a Master of Science Degree in 1937. In 1930 I acquired the Illinois C.P.A. Certificate by examination and was granted a Colorado C.P.A. certificate in 1946 under a reciprocal arrangement. I hold memberships in the American Institute of Accountants, American Accounting Association, Federal Government Accountants Association, as well as Beta Gamma Sigma and Beta Alpha Psi, the latter two being collegiate professional and honor societies.

From 1927 to 1934 I was employed by F. W. Lafrentz & Company, a national firm of certified public accountants. From 1934 to 1936 I was top senior accountant in the Chicago office of Deloitte, Plender, Griffiths & Company, an international firm of public accountants. This nine years of public accounting experience was quite diversified, but was mainly concerned with audits, tax returns and special investigations for public utility clients.

From 1936 to 1945, except for one period of ten months, I was employed by the Federal Power Commission. My posi-

tion was Principal Examiner of Accounts until May 1941 and then for more than four years I served as Assistant Chief Accountant. Most of the natural gas rate investigations by the Commission during this period were under my direct supervision with respect to the accounting phases. I also testified on such matters as the rate base, cost of service, original cost principles, depreciation principles, working capital and participated extensively in the preparation of financial and accounting data which went into the briefs relating to the cases reviewed in the Federal courts. Important cases upheld in the Federal courts in which I testified and had substantial responsibility were the Canadian River-Colorado Interstate and Cities Service Gas Company cases reported at 3 FPC 32 and 3 FPC 459, respectively.

From 1945 to 1951 I resided in Denver, Colorado. Although my major activity during this period was rendering services to various clients on rate and financial regulatory matters, I served the University of Denver for a period of about two years as Professor of Accounting. I also served, on a part time basis, in the non-partisan administration of Mayor Quigg Newton as Manager of Revenue for the City and County of Denver (in 1948) and as the City's Utilities Officer (1950-1951). While Manager of Revenue I supervised the sale on behalf of the City of some $8,000,000 of general obligation bonds in addition to the routine supervision of a department having 300 employees. This department performs the assessment, collection and distribution of state, local and school district property taxes as well as the city sales and excise taxes. It also issues all automobile licenses in the City and County of Denver.

During the period I served as Utilities Officer, Denver enjoyed "home rule", with power to regulate utility rates and services. As Utilities Officer I was the city's representative in substantially all of its relationships with the electric, gas, telephone and mass transportation utilities, as well as taxicab companies, operating in the city. I also represented the city in all matters pertaining to Denver's utility services (other than water), before State and Federal regulatory agencies made continuing studies and performed numerous routine duties relating to utility rates and services in the city,

and advised the Mayor and City Council on policy matters pertaining to public utilities and taxicab operators.

In 1951 I returned to the Federal service as Assistant Controller of the Rural Electrification Administration. I had the major responsibility for shaping the accounting and auditing policies followed by REA and recommended by it to its borrowers. I also served as the principal consultant to the agency on financial matters affecting borrowers. In 1953, upon abolishment of the controller and auditing functions of the REA staff, incidental to a major reorganization, I returned to the staff of the Federal Power Commission in my present capacity.

For use in this proceeding I have prepared Exhibit No. ....., consisting of two schedules, which sets forth the cost of service and rate base related to sales to Georgia Power Company for the year 1956 based on the showing made by the company in this proceeding. An assumed rate of return of 5½% and an assumed Federal income tax rate of 52% were used in computing such cost of service. I am not necessarily recommending, however, that these percentages be adopted for return and tax rates. While their use is provisional in this study, the methods of applying whatever rates are found proper for return and Federal income tax are appropriately illustrated in the Exhibit. Also for the purpose of classifying the various items of cost of service between energy and capacity costs the general pattern provided in Power Contract dated November 9, 1951 between the respondent and Georgia Power Company was followed.

Data for the year 1956 were selected to indicate the cost of service which can be expected to be representative of the immediate future. Beyond the immediate future foreseeable changes in the rate base and other possible changes will undoubtedly alter the results shown in this exhibit.

While the exhibit is based on data and information relating to the year 1956 in the showing of South Carolina Generating Company, I have made several modifications of the company's conclusions in order to obtain a proper cost of service. A field examination would possibly reveal the necessity of further adjustments. My modifications are summarized briefly as follows:

Item No.

1. The rate of interest capitalized during construction on equity funds has been reduced from 8% to 6% per annum.
2. A composite annual depreciation rate of 2.75% has been applied in accordance with the company's practice in keeping its books and issuing financial reports to investors, in preference to the 3% annual rate claimed by it for rate making purposes in this proceeding.
3. Interest deductions used for the purpose of computing the Federal income tax allowance are those for the actual financial structure of this company in preference to an assumed capitalization proposed by the company.
4. A depreciation rate of 3.25% was used in computing the Federal income tax allowance, representing the rate claimed and expected by the company to be allowed by the Internal Revenue Service, for income tax purposes. The company used 3%.
5. The company's claimed cash working capital has been reduced by eliminating natural gas purchased from the operating expenses for which cash working capital must be provided and by making a deduction for working capital funds provided to the company through income tax accruals collected from customers in advance of actual payment thereof to the tax collecting agency.

Further discussion of the necessity and propriety of these modifications is as follows:

Item No. 1—Interest During Construction

Electric Plant Accounts Instruction No. 5 (Paragraph 17) of the Commission's Uniform System of Accounts provides for capitalization, at a reasonable rate of interest during construction associated with the use of the utility's own funds. This applies to equity funds. In several decisions the Commission has held that 6% per annum on equity funds is the maximum reasonable rate for the purpose of computing interest during construction. Among the decisions in point are the following:

Northern Natural Gas Company, Opinion No. 228, P. 11 (Mimeo.ed.) June, 1952.

Michigan-Wisconsin Pipe Line Company, Opinion No. 275, p. 14 (Mimeo. ed.) July 1954.

Transcontinental Gas Pipe Line Corporation, order of November 9, 1954 in Docket No. G-2075.

Accordingly, Interest on Equity funds in the amount of $242,154.39 appearing on Exhibit No. 20 was reduced to $181,616, resulting in a downward adjustment of approximately $60,538 to Plant Account. One-half of this deduction or $30,269 was excluded from the rate base I use.

Item No. 2—Depreciation Rate

Since the management of South Carolina Generating Company has used an annual depreciation rate of 2.75% for operating, financial and reporting purposes, with the approval of independent public accountants, the only justification for using a different depreciation rate in this case would be a showing that the 2.75% rate is erroneous or otherwise inappropriate for the purpose of computing the reasonable cost of service. The testimony of Mr. W. J. Ready at Page 7 of Exhibit No. 2 and at pages 618 to 648 and 848-849 of the transcript has to do with this matter.

I understand Mr. Ready's testimony to mean, in essence, that increasing the annual depreciation rate from 2.75% to 3% is justified for the purpose of this rate case because of impending changes in the art, proximity of the plant to alleged extraordinary potential physical hazards and the risk of error inherent in making long range estimates.

With regard to impending changes in the art, South Carolina Generating Company, as I understand the facts, is not in a different position from other producers of electrical energy generally and Mr. Ready testified that producers generally have not increased their depreciation rates due to such a factor. It is common knowledge that depreciation rates used by electric utilities generally during at least the past 15 to 18 years reflect an allowance for changes in the art.

So far as the hazard and risk referred to are concerned there is likewise no justification for increasing the depreciation rate to 3%. It is not the purpose of the annual depreciation allowance to provide compensation for such hazards and risks. In this connection I might refer to definition No. 13 of the Uniform System of Accounts. Therein depreciation is

specifically restricted to factors "known to be in current operation and against which the utility is not protected by insurance." Causes specifically listed in the definition are "wear and tear, decay, action of the elements, inadequacy, obsolescence, changes in the art, changes in demand and requirements of public authorities." This does not mean, however, that the utility is denied compensation for its risks. Through a recognition of its capital costs, as determined by the market place, in accordance with principles enunciated in the *Bluefield* and *Hope Gas Company* cases, such risks are compensated for in the rate of return allowance. To compensate these risks again in the depreciation allowance would result in duplicate charges against the ratepayer and a windfall to the utility.

Item No. 3—Interest Deductions for Income Tax Computation

South Carolina Generating Company contemplates filing a separate Federal income tax return for the calendar year 1954. According to the evidence it appears likely, however, that Generating Company's operations will be included in a consolidated return in 1955 and some years thereafter in order that its parent can realize, at least temporarily, the tax advantages flowing from rapid amortization of certain of the Generating Company's facilities.

The respondent proposes to substitute hypothetical interest deductions for actual in computing the income tax allowance. This raises the question of whether such extraordinary procedure would result in the fairest possible distribution of the tax cost consistent with the existing relevant facts.

The company contends that the interest deduction for the purpose of computing the income tax allowance in this case should be on the basis of hypothetical 50% ratio of debt to total capitalization. This would have the effect of increasing the tax allowance, with a consequent benefit to the parent company. Although it is claimed that the desirability of a 50% debt ratio, and the practice of the industry warrant an expectation that the Electric and Gas Company system on a consolidated basis will attain such a debt ratio at some undetermined time in the future the fact remains that a 50%

ratio is non-existent at this time and there is no assurance that it will be attained at any particular time.

Even if the system had, or expected to attain, a 50% debt ratio at some specific date, the company's position with regard to this tax deduction would rest on the premise or assumption that the Generating Company is no more than a department of the parent company or of the parent and subsidiaries as a group. This approach has merit in some instances but it does not square with realities when the manner of assessing and collecting income taxes is fully considered. Based on a fundamental principle of cost accounting, in making a fair and reasonable assignment of the tax cost, as in this case, the realities cannot be ignored. Of significance are the following considerations:

Generating Company is a separate corporate entity; it is the contracting and operating entity which renders the service to Georgia Power Company and other customers; it is entitled to file a separate tax return; it would file a separate return were it not for the benefits to the parent flowing from filing a consolidated return; Generating Company has certain specific deductions for interest to which it would be entitled and would use upon the filling of a separate tax return; the benefits of Generating Company joining in filing a consolidated return flow entirely to the parent company with no portion thereof accruing to Generating Company; joining in the filing of a consolidated return does not deprive Generating Company of its status or alter its responsibilities as a separate corporate entity and taxpayer.

In view of the facts, the conclusion that sound cost accounting requires the use of Generating Company's own interest deductions in computing its income tax allowance for rate making purposes is, in my opinion, inescapable. To conclude otherwise would result in using a synthetic tax allowance not consistent with the underlying facts. Under the company's proposal the customer would be required, in my opinion, to pay for more in the income tax component of cost of service than the taxes actually payable by Generating Company. They would also pay more than can be allocated to the Generating Company's cost of service in accordance with good accounting practice.

Item No. 4—Use of 3.25% Depreciation Rate for Income Tax Computation

The Company stated that it has claimed 3.25% for depreciation on its Federal income tax return and expects such amount to be allowed by the Internal Revenue Service for statutory purposes. Under these conditions the use of a lower depreciation rate in computing the income tax allowance for the purposes of this rate case would return the company an additional profit over and above the fair return. The imposition of any such duplication of costs on the customers is not proper accounting and would be erroneous as a procedure in fixing utility rates.

Item No. 5—Working Capital Allowance

The purpose of the working capital allowance in rate-making is to enable the utility to earn a fair return on the materials, supplies and cash devoted to the utility operations to the extent that these are actually provided by investor's funds. Customers may also provide working capital funds to the utility by paying for service in advance of the time the utility pays for the costs, or some of the costs, of providing the service. It is fundamental, therefore, that capital supplied by the customers should not be included in the rate base. This requires consideration of the time revenues are collected from customers in relation to the time payment is made of various expenses.

Exhibit 24 shows that Georgia Power Company pays its power bill by or before the time Generating Company pays its bill for gas consumed in rendering the service to Georgia. Accordingly, it is not necessary to provide working capital from investors' funds for payment of Generating Company's gas bills.

The Federal income tax is another element of cost of service not paid by the utility until after a substantial lapse of time subsequent to recovery of such cost from customers through bills paid for service. The Federal Power Commission's standard practice of taking into account in the working capital allowance the tax accrual funds provided by customers to the utility in advance of payment thereof to the taxing authorities has been approved by the courts. Refer-

ence is made to *Alabama-Tennessee Natural Gas Company* v. *F. P. C.* 203 F2d 494 and *Northern Natural Gas Company* v. *F. P. C.* 206 F2d 690, certiorari denied, 346 U. S. 922.

For 1956 the portion of the Federal income tax allowance to be credited to the customer's contribution of working capital, in accordance with the Commission's policy of taking into account the lag between the time of collection and payment of Federal income tax funds by the utility, is 68%. This percentage has been utilized in computing the working capital allowance reflected in the rate base.

The testimony which follows is directed to cost classification and rate form. In my opinion, the classification of costs in my exhibit as between the energy and capacity components is suitable for use in connection with this proceeding. Although the separation followed in the Exhibit has the effect of allocating 100% of the fixed costs to the capacity component, it is believed to be suitable and reasonable for the purposes of this particular case. Under other conditions it might be appropriate to split the costs of depreciation, taxes and return on a 50-50 basis between the energy and capacity components. Here, however, in view of the right of Georgia Power Company to the capacity and the impracticability of Generating Company disposing of the output of the capacity devoted to Georgia service to other customers, the inclusion of all of the fixed costs in the capacity or demand charges to be paid by Georgia Power Company appears justified. It should be recognized, however, that by this method of cost allocation and rate making, substantially all of the risks associated with ownership of 50% of the capacity of the Urquhart Plant are shifted from Generating Company to Georgia Power Company. This is a very important consideration. Thus, Generating Company is assured, through Georgia Power Company's credit, and the latter's status as a sound going public utility, of a profitable, practically risk-free, tax-free investment in 50% of the plant. Generating Company's parent will obtain the rapid amortization tax benefits on the plant. In addition, according to the contract, Generating Company may terminate the service by giving the required notice, at any time conditions are such that the cancellation would be advantageous to Generating Company or its parent.

In the years subsequent to 1956, under normal conditions, Generating Company's rate base applicable to Georgia Power will decrease due to the increase in the depreciation reserve. The magnitude of the net decrease in the rate base will depend, however, to some extent upon the amount of plant retirements, replacements and additions which may be made to Units Nos. 1 and 2. These do not appear in the record.

As the rate base decreases the elements of cost of service to Georgia Power representing return and possibly income taxes would decrease. The present rate schedule of South Carolina Generating Company, FPC No. 1, however, does not adjust the charges to Georgia Power Company to reflect the decrease in rate base resulting from the accruals to the depreciation reserve.

Assuming that the depreciation reserve will increase yearly at the rate of 2.75% of depreciable plant, Generating Company's capacity cost of service to Georgia Power would decrease by roughly $1.30 to $1.40 per kilowatt during each five year interval after 1956.

Although return will be the substantial variant in terms of the dollars involved, other elements of cost may also be affected. Tax rates, assessments and other factors affecting the amount payable may change up or down. Operating expenses will probably vary. There is some indication that the Federal income tax rate may be reduced from 52% to 47% by next April 1.

Notwithstanding that changes in the cost to serve Georgia Power in subsequent years are certain to occur, it is my opinion that the Commission would be justified in prescribing a fixed annual charge for the present capacity service rendered to Georgia Power by Generating Company. Regulation is a continuing process. No rate can ever be regarded as fixed or appropriate for all time. The propriety and necessity of periodic re-examination is obvious. Such procedure unquestionably is fair and reasonable for all concerned.

The Exhibit shows that Generating Company's capacity cost to serve Georgia Power amounts to $1,632,640 for the year 1956. I recommend that the Generating Company's rate schedule provide for an annual capacity charge of this amount to be paid in equal monthly installments. In addition, the present energy charge provisions of FPC Rate Sche-

dule No. 1 would be retained. It would be necessary, however, to revise the capacity charge in the future depending upon the changes which may occur in the capacity cost elements.

Assuming that the Commission prescribes a fixed annual capacity charge, I do not recommend a provision, as in the present schedule to adjust such a charge automatically for changes in plant investment and expenses. Although it appears that the adjustment most likely to affect the result significantly would result in a lower charge, I do not favor retaining automatic adjustment of the demand charge, generally speaking. If the cost goes up, the Generating Company can apply for a higher rate; if it goes down, the Commission can and should prescribe a lower rate, after a reasonable interval has elapsed. The matter of adjusting the capacity charge for lowering of the Federal income tax rate will be covered subsequently in my testimony.

To provide for a fixed annual charge certain modifications of the present rate schedule are necessary. I suggest that those Sections in Article III which are inconsistent with the provision for a fixed annual charge payable monthly be eliminated from FPC Rate Schedule No. 1. In the first paragraph of Section 3.02 the amount of $21.769 per kilowatt would be substituted for the present $22.50 capacity charge. Section 3.02(a) should be retained, but Section 3.02(b), (c), (d), and (e) would be eliminated. Sections 3.03 and 3.04 would be retained and Section 3.05 should be modified so as to be consistent with the foregoing.

With the elimination of the so-called escalator clauses relating to the demand charge, I recommend that the second full paragraph of page 30 of Rate Schedule No. 1 be eliminated to permit either Generating Company or Georgia Power to petition the Commission for a change in the rate.

In addition to the foregoing it is recommended that any order of the Commission fixing a new demand charge provide for a reduction therein in the event the Federal income tax rate is lowered.

Exhibit 45

Attached to the Testimony of Kenneth L. Smith

SOUTH CAROLINA GENERATING COMPANY

Cost of Service
(Georgia Power Company Sales)
Year 1956

Particulars	Total	Cost Classification[1] Energy Costs[2]	Capacity Costs
Operation and Maintenance			
Fuel	$ 1,309,000	$ 1,309,000	$
Maintenance	33,400	32,900	500
Other	187,200		187,200
Total Operation and Maintenance	$ 1,529,600	$ 1,341,900	$ 187,700
Depreciation	372,985		372,985
Taxes—Other than Income	119,500	7,500	112,000
Income Taxes:			
Federal	210,743		210,743
State	43,247		43,247
Return at 5.50%	707,065		707,065
Credits for Rents	(1,100)		(1,100)
Total Cost of Service	$ 2,982,040	$ 1,349,400	$ 1,632,640
KWH (,000)		466,500	
Energy Cost per KWH		$ .0028926	
Contract Demand—KW			75,000
Cost per KW of Contract Demand			$ 21.769

[1] Classified between energy and capacity costs in accordance with the general pattern provided in Power Contract dated November 9, 1951.

[2] Statement 2(b)-1 of Exhibit No. 7

SOUTH CAROLINA GENERATING COMPANY

Rate Base and Return
Year 1956
(Georgia Power Company Sales)

Particulars	Amount	Source
Plant:		
Gross Average Investment	$ 13,674,331	Note (1)
Less: Average Depreciation Reserve	916,420	Note (2)
Average Net Plant Investment	$ 12,757,911	
Working Capital Requirement:		
Material and Supplies	$ 195,400	Statement 1(d) Ex. 7
Cash for expenses	45,725	Note (3)
Credit for tax accrual funds	(143,305)	Note (4)
Net Working Capital Requirement	97,820	
Total Rate Base	$ 12,855,731	
Return—at 5.50%	$ 707,065	

Notes—

[1] Average Plant—1956—Statement 1(d), Ex. 7 ..... $13,704,600
Adjustment to reduce interest capitalized on equity funds from 8% to 6%.... 30,269

As adjusted above $13,674,331

[2] Statement 1(b)-1 of Ex. 7 recomputed on basis of 2.75% rate.

[3] Represents ⅛ of operation and maintenance expenses exclusive of natural gas fuel purchased.

[4] Represents 68% of allowance for Federal income tax expense or the portion thereof available for working capital.